Henderson Far East Income

Asian income fund with a growth emphasis

Investment trusts

Henderson Far East Income (HFEL) seeks to provide both income and capital appreciation by investing in equities in the Asia-Pacific region. The manager's approach is differentiated by an equal division of the portfolio between stocks chosen for their current yield and those chosen for dividend growth prospects. Stock selection prioritises cash flows and this contributes to a relatively defensive profile (beta 0.85), which may well appeal to investors following recent market uncertainty.

12 months ending	Total share price return	Total NAV return	FTSE All-World Asia-Pacific ex-Japan	FTSE All-World	FTSE All-Share
31/01/11	20.7	19.0	26.0	20.1	18.1
31/01/12	(5.0)	(3.6)	(4.0)	(1.7)	(0.3)
31/01/13	24.6	23.5	13.9	15.1	16.3
31/01/14	(11.3)	(8.3)	(8.0)	9.2	10.1

Note: Twelve-month rolling discrete performance. All % total return in sterling terms.

Investment strategy: Sustainable cash flow growth

The manager looks for companies with sustainable and growing cash flows. While the portfolio is divided 50-50 between yield and dividend growth plays, capital would not be sacrificed in the interest of maximising income. The approach is primarily bottom-up, with top-down views being a source of ideas rather than dictating allocations between countries or sectors. The team is keen to identify companies that could deliver positive dividend surprises; its cash flow analysis and full schedule of meetings with management helps in this task. The manager employs an option-writing strategy to enhance revenues, which also has the benefit of allowing greater freedom to invest in companies with growth potential. The options exposure is typically 2-3% of NAV.

Asian market outlook: Challenges and opportunity

The medium-term economic outlook for the Asia-Pacific ex-Japan region, as reflected in projections of the IMF and others, is for faster growth than for the world as a whole. This may not translate directly into a stronger market performance in the region, but on a longer view seems likely to feed through to earnings and hence share prices. There are uncertainties currently associated with the impact of QE tapering, China's growth normalisation and political events (such as in Thailand). Nevertheless, valuations seem relatively attractive both by geographical and historical comparison (see Exhibit 6), so it is likely the market is already making some allowance for this. The manager has a positive view, reflecting in particular the wider adoption of a dividend culture in the region and the potential for payout ratios to increase from their current relatively low levels (Exhibit 7).

Valuation: Close to NAV

The shares trade on a modest premium to ex-income NAV (2.8%) and over the last year have traded in a relatively narrow range (1% discount to 6% premium). Given the 5.7% yield, which is higher than both the Asia-Pacific ex-Japan investment company sector and the other companies with income mandates, it seems reasonable to expect the shares to continue to trade within their recent range.

13 February 2014

Price	**303.75p**
	NZ$6.05

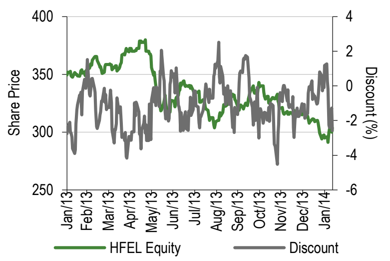
See page 12 for performance in NZ$ terms.

Market cap	**£318m**
AUM	**£341m**
NAV*	295.60p
Premium to NAV	2.8%

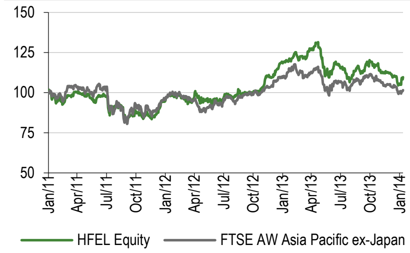
*excluding income.

Yield	5.7%
Ordinary shares in issue	104.7m
Code	HFEL
Primary exchange	LSE
Secondary exchange	NZSX
AIC sector	Asia-Pacific ex-Japan

Share price/discount performance*



Three-year cumulative perf. graph



52-week high/low	380.0p	291.0p
NAV* high/low	370.60p	290.40p

*Including income.

Gearing

Gross	6.0%
Net	6.0%

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Edison profile page

Henderson Far East Income is a research client of Edison Investment Research Limited

Exhibit 1: Henderson Far East Income at a glance

Investment objective and fund background

Henderson Far East Income aims to provide investors with a high level of dividends and capital appreciation over the long term, from a diversified portfolio of investments traded on the Pacific, Australasian, Japanese and Indian stock markets (Asia-Pacific region). The fund is classified by the AIC in the Asia-Pacific ex-Japan category and, while it does not have a benchmark, sees the FTSE World Asia ex-Japan index as providing the most appropriate comparator. While the fund does hold Japanese investments, they are not expected to be a substantial part of total assets.

Recent developments

18 December 2013: IMS for three months to end November. Allocation to China increased in period. NAV total return 3.6%.
15 November 2013: Annual results. Annual management fee reduced from 1.0% to 0.9%.

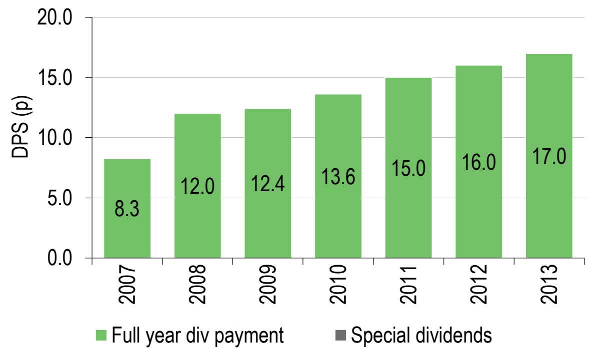
Forthcoming		Capital structure		Fund details	
AGM/shareholder event	December 2014	Total expense ratio	1.3%	Group	Henderson Global Investors
Preliminary results	November 2014	Net gearing	6%	Manager	Michael Kerley
Year end	31 August	Annual mgmt fee	0.9% of net assets	Address	201 Bishopsgate, London, EC2M 3AE, UK
Dividend paid	May, Aug, Nov, Feb	Performance fee	None		
Launch date	2006 (as a Jersey co.)	Trust life	Indefinite	Phone	0800 856 5656
Continuation vote	No	Loan facilities	£45m one year (Feb 2013)	Website	www.henderson.com/ukpi/fund/201

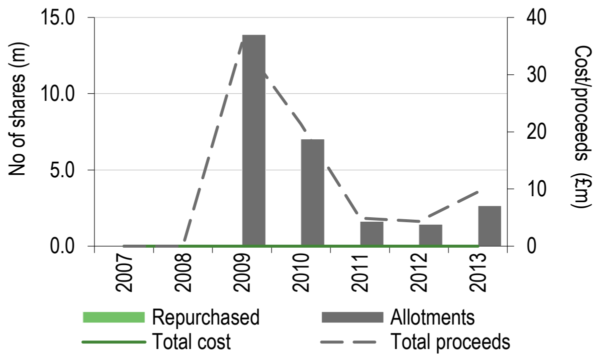
Dividend payments

Dividends paid quarterly. The company aims to distribute substantially all its income profits arising in each accounting period.

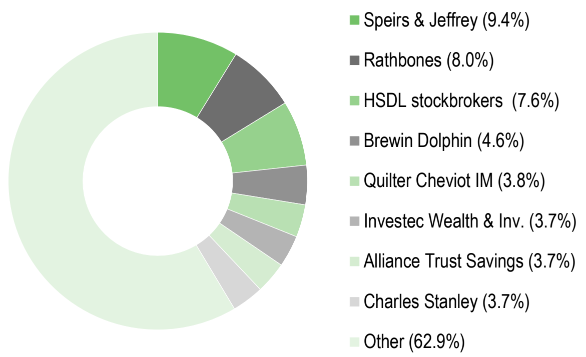
Share buyback policy and history

HFEL is authorised to repurchase up to 14.99% of its ordinary shares to hold up to 10% of shares in treasury and issue up to 10% of shares.

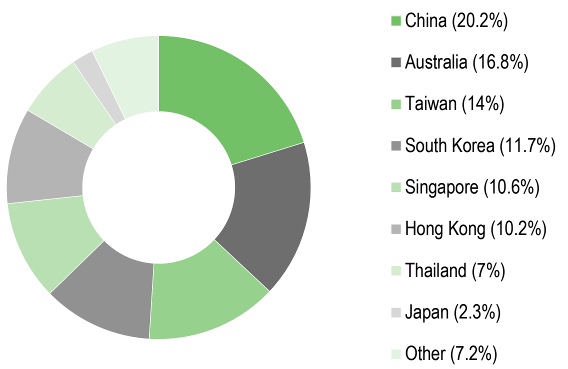




Shareholder base (as at 31 January 2014)



Geographical exposures of portfolio (as at 31 December 2013)



Top 10 holdings as at end December

			Portfolio weight %	
Company	**Country**	**Sector**	**31 December 2013**	**31 December 2012***
Hyundai Motor	Korea	Automotive	3.0	N/A
Bank of China	China	Banking	2.9	2.7
SK Telecom	Korea	Telecom	2.8	2.7
Taiwan Cement	Taiwan	Construction Materials	2.7	N/A
SJM Holdings	Hong Kong	Casinos and Gaming	2.7	N/A
Shanghai Industrial	China	Real Estate/Conglom.	2.6	2.6
Grand Korea Leisure	Korea	Travel, Lodging & Dining	2.6	N/A
Catcher Technology	Taiwan	Industrials	2.4	N/A
Sinopec Engineering	China	Oil, Gas & Coal	2.3	N/A
Charoen Pokphand Foods	Thailand	Food Manufacturing	2.3	2.8
Top 10			**26.3**	**N/A**

Source: Henderson Far East Income, Edison Investment Research. Note: *Top 10 – N/A where not in top 10 at end December 2012.

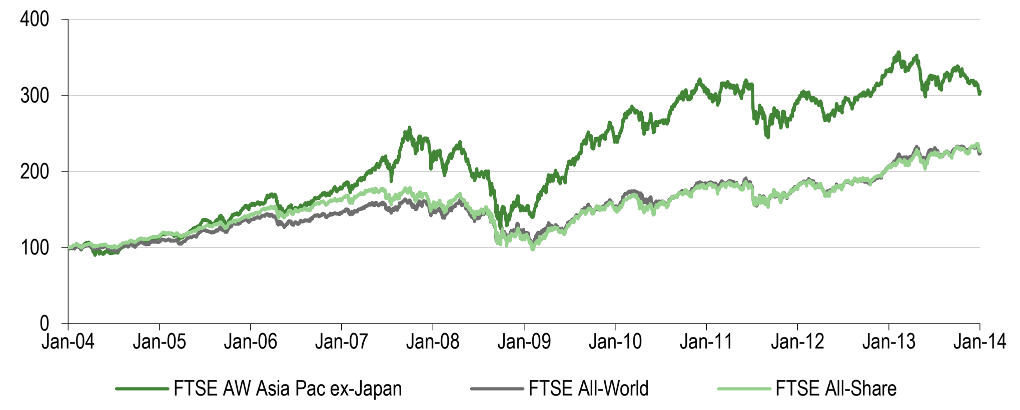
Asia-Pacific market outlook: Long-term growth

Many investors choose to gain international exposure through open- or closed-ended funds given the diversification, administrative and stock selection benefits they can offer. The Henderson Far East Income fund offers one way of addressing this requirement for the Asian region with the addition of a specific income mandate providing a particular "tilt" compared with more general Asian funds. While HFEL can and does invest in Japan, it is not expected to be a significant part of the portfolio. As a result, the fund employs an Asia-Pacific ex-Japan index for comparison and our outlook comments are also focused on this part of the region.

Before looking at the economic and political prospects, it is worth setting the scene by reviewing recent market performance. Exhibit 2 shows the FTSE All-World Asia-Pacific ex-Japan index compared with the FTSE All-World and FTSE All-Share indices.[1] This shows that the Asia-Pacific ex-Japan index outperformed both the World and the UK markets over the 10-year period. The regional index also displayed greater volatility than the All-World/All-Share indices both entering and leaving the financial crisis: underperforming from late 2007 to late 2008, then outperforming into the second half of 2009 as the flight to perceived safety abated and the relative strength of Asian growth came to the fore. More recently, the Asia-Pacific ex-Japan index has seen a weaker performance than either world (dominated by US) or UK markets, particularly once markets began to discount QE tapering. As the indices shown are sterling adjusted, they capture the effects of currency fluctuations that are a source of volatility in capital values and revenue earnings to a largely unhedged fund such as HFEL.

In summary, Asia-Pacific ex-Japan equities have comfortably outperformed the world average over 10 years, delivering an 11.8% annualised total return versus 8.8%, but in the near term have lagged noticeably. This prompts two thoughts: first, the historical volatility suggests investors should be prepared to take a longer-term view when investing in the region; and second, recent relative weakness may in due course be seen as an investment opportunity.

Exhibit 2: FTSE All-World Asia-Pacific ex-Japan, All-World and FTSE All-Share indices



Source: Thomson Datastream. Note: Sterling-adjusted, total return indices.

To consider the outlook, we start with economic forecasts. Exhibit 3 shows IMF projections from October 2013[2] and historical data to demonstrate the more rapid economic growth recorded by and expected for the Asia-Pacific ex-Japan region when compared with advanced economies. GDP growth of an estimated 5.7% last year was below the 2005-12 average of 7.4%, but still more than

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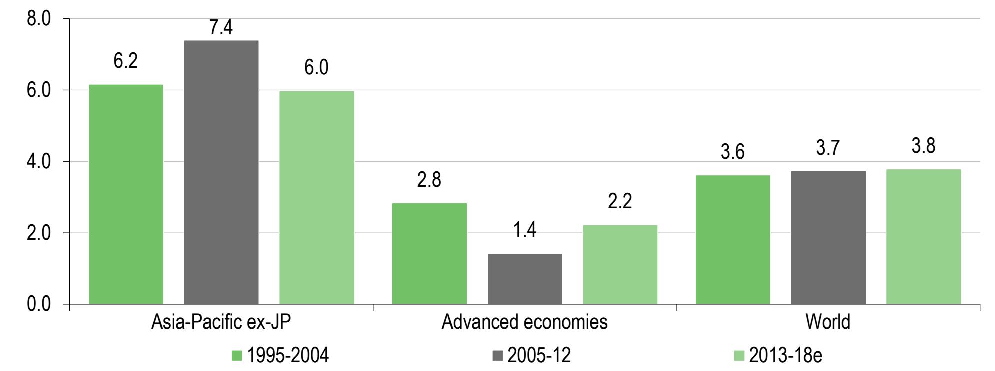
1 All total return and in sterling.

2 IMF projections have been updated in January 2014 but the changes were modest with the world growth projection raised by 0.1% for 2014 and unchanged for 2015. The growth estimates for developing Asia (includes China) were increased by 0.2% for both years to 6.7% and 6.8%.

four times the 1.2% estimated for advanced economies and nearly double the world average of 2.9%. The IMF estimates for 2013-18 point to average growth of 6.0% for Asia-Pacific ex-Japan compared with 2.2% for advanced economies.

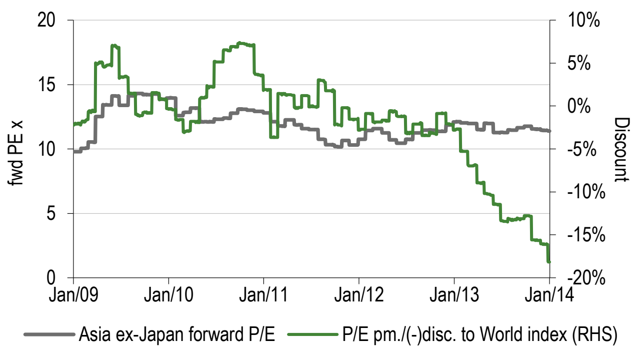
Exhibit 3: Average % real GDP growth – Asia-Pacific versus advanced economies and world



Source: IMF October 2013 forecast, Edison Investment Research

The economic estimates therefore continue to suggest a relatively favourable background in the Asian region, although significant risks remain, including concerns over non-bank lending in China and the volatility of capital flows, a source of recent market volatility. The linkage between economic trends and stock market performance is not direct, but if the global and Asian economies navigate the various risks they face then, on a longer view, there would seem to be reasonable grounds to expect Asia-Pacific markets to outperform the world average.

Exhibit 4: Asia ex-Japan index prospective P/E



Source: Thomson Datastream. Note: Datastream index.

Exhibit 5: Datastream Asia ex-Japan index metrics

	Last	High	Low	10-year average	Last % of average
P/E (12 mths fwd x)	11.3	16.9	8.7	12.1	93%
Price to book x	1.6	2.8	1.1	1.8	93%
Dividend yield %	2.7	5.1	1.7	2.6	105%
Return on equity %	13.3	17.2	9.9	14.5	92%

Source: Thomson Datastream

The chart above (Exhibit 4) shows that while the prospective P/E for the Datastream Asia-Pacific ex-Japan index has been relatively stable over the last year, it has also moved to a significant 18% discount to the world market P/E, reflecting in particular the relative strength of the US market. The current Asia ex-Japan P/E of 11.3x is modestly below its 10-year average (Exhibit 5) and compares with world and US market multiples of 13.7x and 15.7x respectively.

Other valuation measures shown in Exhibit 5 (dividend yield and the price to book in the context of return on equity) are either in line with (yield) or below the 10-year averages, suggesting that valuation should not be an obstacle to regional performance. International comparison on these measures also tends to support the relative attractions of the Asia-Pacific region (world prospective P/E 13.7x, price to book 2.0x, return on equity 11.1% and dividend yield 2.5%) .

Having set out these regional averages for Asia-Pacific ex-Japan, it is worth including one table that highlights the differences between selected country markets (Exhibit 6 shows prospective P/Es), in turn reflecting varied economic positions and the stock market composition in each case.

Exhibit 6: Asia-Pacific –prospective country P/Es

Price to earnings (forward)	Last	High	Low	10-year average	Last % of average
Australia	13.9	16.2	8.8	13.2	106%
China	8.4	36.8	8.3	15.2	55%
Hong Kong	12.4	19.6	9.1	13.6	91%
India	12.3	19.7	8.6	13.3	92%
Indonesia	13.9	15.9	5.9	12.4	112%
Japan	13.2	22.1	10.3	15.3	86%
Korea	9.2	12.6	6.5	9.4	98%
Malaysia	15.7	16.3	10.9	14.2	111%
New Zealand	15.9	19.0	8.8	12.8	124%
Pakistan	8.4	11.8	5.6	8.6	98%
Philippines	15.9	19.0	8.8	12.8	124%
Singapore	13.0	17.2	8.5	13.5	96%
Taiwan	14.5	18.1	10.1	13.1	110%
Thailand	11.5	14.2	6.7	10.9	106%
Asia ex-Japan	11.1	16.9	8.7	12.1	92%
US	15.6	16.0	9.3	13.1	119%
World	13.5	14.4	8.7	12.0	112%

Source: Thomson Datastream

Our conclusion in terms of the investment outlook for Asia-Pacific ex-Japan is that, while there are considerable economic uncertainties and in some countries political risk (Thailand is an example currently), the region appears relatively attractive both in terms of prospective economic growth and stock market valuations. This provides an encouraging context within which the manager of Henderson Far East can make his stock selections. Mindful of the relative volatility regional markets displayed through the period of the financial crisis, the fund's income mandate and focus on sustainable cash flows has the potential to deliver lower volatility than the markets it is addressing.

Fund profile: Asian income and growth

Re-domiciled in Jersey in 2006 as Henderson Far East Income Limited, the original trust was formed in 1930. The company is quoted on the London and New Zealand stock exchanges. The company aims to generate dividend income and capital gains through investment in the Pacific, Australasian, Japanese and Indian stock markets. While the Asian remit is therefore broad and the trust does have investments in Japan, in practice the manager does not envisage the Japanese exposure rising significantly (currently sub-3%) given the subdued dividend growth potential seen in that market. Classified by the AIC in the Asia-Pacific ex-Japan sector, the fund also uses the FTSE All-World Asia-Pacific ex-Japan index for comparison given the current disposition of assets. It is one of three UK-listed investment companies in its sector with an income mandate and currently offers the highest dividend yield at 5.7%. The manager adopts a differentiated approach to managing the portfolio to deliver income by dividing it into a portion with stocks held for high yield and another consisting of stocks with good prospects for dividend growth. An option-writing programme makes a moderate contribution to revenues, last year generating income equivalent to approximately 0.5% in additional yield.

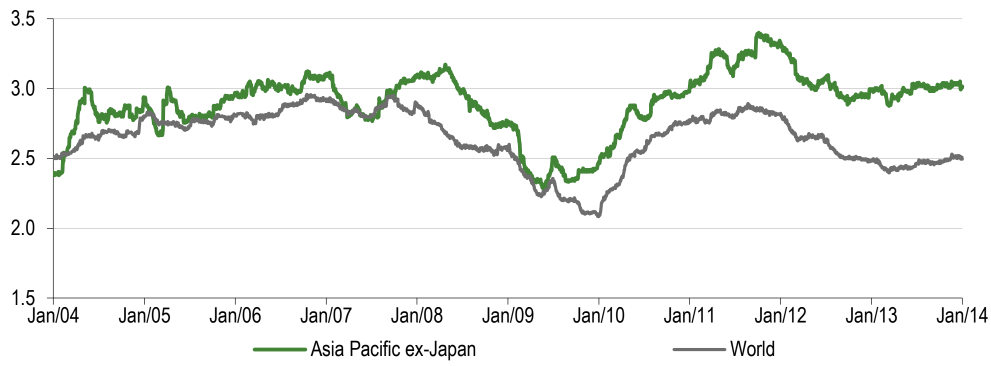
The fund manager: Michael Kerley

The manager's view: Optimistic on Asian income growth

While acknowledging near-term uncertainties surrounding issues such as the level of Chinese growth and political developments in Thailand, the manager has a positive view on the potential returns from an Asian income strategy. He highlights consensus earnings growth estimates for the current year of about 10% and sees capacity for dividend growth to outpace this. This reflects the wider adoption of a dividend-paying culture and a greater awareness of the importance of cash flows that accompanies the tempering of growth rates compared with earlier periods.

As shown in Exhibit 7, the level of dividend cover in Asia-Pacific ex-Japan is significantly higher than for the world index (Datastream indices), a gap that opened up after the financial crisis and has yet to contract significantly. This suggests the potential for payout ratios to increase producing positive dividend surprises even if earnings were to disappoint modestly versus consensus expectations.

Exhibit 7: Dividend cover – Asia-Pacific ex-Japan and world



Source: Thomson Datastream, Edison Investment Research. Note: Datastream indices.

The manager notes that potential income investors in Asia are likely to be interested in exposure to the superior growth in the region and for this reason divides the portfolio into two sections, one with higher-yielding stocks and the other with stocks he believes have good dividend growth prospects. He believes this approach differentiates the fund from other income funds.

While the fund may invest in Japan and has recently made some investments in the country, the manager comments that the exposure is likely to remain limited given the growth profile compared with other countries in the region. In this instance, the portfolio's currency exposure has been hedged given that a positive view on Japan is closely linked with a relatively weak yen. Other currencies are not hedged, as the manager would only do this when there was a similarly clear rationale.

With regard to Thailand, where the portfolio has four holdings, the manager regards the political outlook as uncertain, a situation that seems unlikely to be resolved quickly, even now the election has taken place. The portfolio has four holdings in Thailand, with two in less sensitive areas (a mobile operator and a food company); the manager has chosen to maintain the position rather than exploit apparently appealing valuations given the uncertainty.

Asset allocation

Investment process: Cash flow is the key

While income forms part of the company's objective, the manager follows a total return policy with the view that investors in Asia-Pacific want exposure to the dividend growth potential in the region. To this end, the portfolio is divided roughly 50-50 between stocks that are held for their high yield and those bought for dividend growth. The high-yielding stocks are selected for their excess cash generation and their ability to pay decent dividends. Given that they lack the growth of the other part of the portfolio, the manager is careful not to overpay for this income. A DCF valuation framework is used to assess this. The manager avoids putting capital at risk for the sake of incremental income, but the average portfolio yield at end December 2013 was 4.1% compared with 2.8% for the index.

Stock selection centres on the investment team's view of companies' ability to generate sustainable, growing cash flows. The approach is therefore primarily bottom-up, with top-down views being used for idea generation rather than for allocation between countries or sectors. Screens are used to narrow down candidate investments, identifying those meriting closer attention. Company meetings are an important part of the investment process. Research provides a context for the discussion with management during which the team will gauge responses to their suggestions relating to potential actions to enhance shareholder value. As part of the process, the manager is particularly looking for situations where there is potential for positive dividend surprises (driven by earnings or payout ratio changes).

The manager operates an option-writing strategy with the objective of enhancing yield without increasing volatility significantly. The manager writes puts and calls depending on market conditions. The starting point for option writing is the DCF valuation, from which target prices are derived. If market prices are within 5-10% of the target price for a stock, the team will consider writing an option with a strike price in line with the target price. In the seven years the strategy has been employed, about 10 options a year have been written, so activity levels are not high and the maximum exposure has been equivalent to 9% of the portfolio with a more typical level being 2-3%. The manager observes that option premium income tends to be countercyclical as premium levels are higher when markets are volatile, a time when dividend growth is likely to be subdued. The company analysis of returns from the strategy shows that, allowing for opportunity costs, the contribution to performance over the whole seven-year period was a modest 1.2% or 0.2% pa on average. Excluding opportunity costs, premium income was equivalent to approximately 0.6% pa of average assets: possibly a more relevant measure as option strike prices are a reflection of the manager's valuation/stock selection process.

The investment team comprises the fund manager Michael Kerley, deputy manager Sat Duhra and analyst Tom Coombes. Michael Kerley is based in London, while Sat Duhra and Tom Coombes are relocating to Singapore during the first quarter of 2014, facilitating company meetings. Michael Kerley travels to Asia four or five times a year. The team has access to the broader resources of Henderson Global Investors, including three other managers and two further analysts in the Asia ex-Japan team. In addition, the team can call on insights of the Pan-Asian research, quantitative and thematic teams. The company board visits Asia once a year, giving it valuable insight into developments in the region and companies in the portfolio.

Overview

The fund has 56 holdings, modestly below its peer group average of 65 holdings; the FTSE All-World Asia-Pacific ex-Japan index has 883 holdings. As at the end of December 2013, the top 10 portfolio holdings accounted for 26% of net assets (peer group average 34%) with the weightings being fairly even compared with peers. At the company's August year end the portfolio was essentially all invested in equities and equivalents, with outstanding put option liabilities at an insignificant level. OTC options and participation notes equivalent to 6.8% of the portfolio are listed; these reflect a tax-efficient way for the company to gain exposure to companies in certain jurisdictions where it would otherwise incur higher withholding tax on dividends. Counterparty exposures with such instruments are monitored and held below 5% of the portfolio. The portfolio characteristics for December 2013 are detailed in Exhibit 8, showing a somewhat lower prospective P/E than for the index, a 1.3 point premium to the index yield and a 1.4 point prospective yield advantage.

Exhibit 8: Portfolio characteristics		
December 2013	HFEL	FTSE All-World Asia-Pacific ex-Japan
Price/book	1.5	1.6
P/E FY1 estimate	11.8	13.1
Dividend yield (%)	4.1	2.8
Dividend yield FY1 estimate (%)	4.5	3.1
ROE (%)	18.2	15.8

Source: Edison Investment Research

Current portfolio positioning

The geographical exposure of the portfolio is set out in Exhibit 9 compared with the weights for the FTSE All-World Asia-Pacific ex-Japan index and portfolio weights for the previous year. Points to draw out here include the fact that the top three countries, China, Australia and Taiwan, account for 51% of the portfolio while, relative to the index shown, the largest active positions are Australia (underweight, reflecting the manager's cautious view on the economy/currency) and Singapore (overweight). Looking at the changes in weight over the last year, all individual changes are sub-5%, with the largest (apart from other countries) being the 3.7 point increase in the Taiwan weighting.

Exhibit 9: Exposure by country (%)

	Portfolio end December 2013	FTSE AW Asia-Pacific ex-Japan weight	Active weight vs index	Portfolio weight/index weight	Portfolio end December 2012	Change from 2012
China	20.2	17.1	3.1	1.2	17.4	2.8
Australia	16.8	24.9	-8.1	0.7	16.5	0.3
Taiwan	14.0	10.6	3.4	1.3	10.3	3.7
South Korea	11.7	14.6	-2.9	0.8	11.8	-0.1
Singapore	10.6	4.9	5.7	2.2	13.2	-2.6
Hong Kong	10.2	11.6	-1.4	0.9	9.9	0.3
Thailand	7.0	2.0	5.0	3.6	9.4	-2.4
Japan	2.3	N/A	2.3	N/A	0.0	2.3
India	2.1	7.1	-5.0	0.3	1.7	0.4
New Zealand	2.1	0.5	1.6	4.2	2.4	-0.3
Other	3.0	6.8	-3.7	0.4	7.4	-4.4
	100.0	**100.0**	**0.0**		**100.0**	

Source: Henderson Far East Income, Edison Investment Research

The sector positioning is illustrated in Exhibit 10 below; financials and industrials are comfortably the largest sectors, with financials having seen a doubling in weighting over the last year although this still leaves a small negative active weight. The largest active weights versus the comparator index are for industrials (positive) and basic materials (negative).

Exhibit 10: Sector allocations (%)

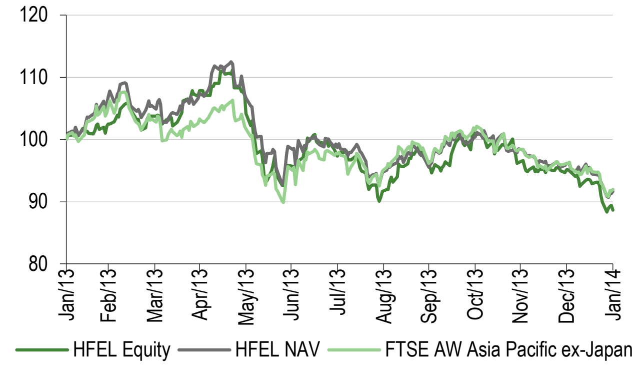
	Portfolio end December 2013	FTSE AW Asia-Pacific ex-Japan weight	Active weight vs index	Portfolio weight/index weight	Portfolio end December 2012	Change from 2012
Financials	32.0	35.6	-3.6	0.9	16.0	16.0
Industrials	22.9	11.2	11.7	2.0	14.3	8.6
Telecommunications	13.4	5.2	8.2	2.6	16.8	-3.4
Consumer Services	10.4	12.1	-1.7	0.9	11.7	-1.3
Consumer Goods	9.0	7.1	1.9	1.3	5.3	3.7
Oil & Gas	6.1	6.4	-0.3	1.0	9.9	-3.8
Technology	6.1	8.5	-2.4	0.7	9.9	-3.8
Basic Materials	0.1	8.7	-8.6	0.0	5.5	-5.4
Other	0.0	5.2	-5.2	0.0	10.6	-10.6
	100.0	**100.0**	**0.0**	**1.0**	**100.0**	**0.0**

Source: Henderson Far East Income

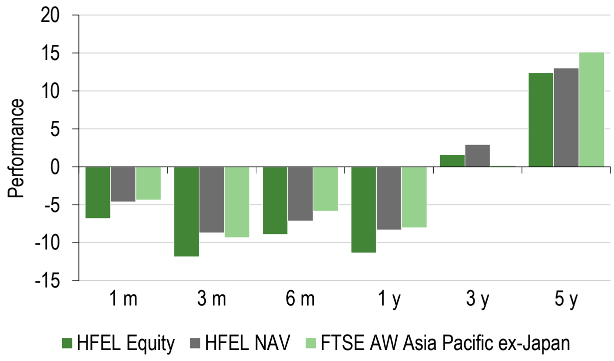
Performance: One- and three-year outperformance

Exhibit 11: Investment trust performance

Price, NAV and FTSE AW Asia-Pac ex-Japan index one-year performance



Price, NAV and FTSE All-World Asia-Pac ex-Japan index (%)



Source: Thomson Datastream, Edison Investment Research. Note: Three- and five-year performance figures annualised. Data to end January 2014. Total return performance.

Exhibit 12: Share price and NAV total return performance, difference versus indices

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price versus FTSE AW Asia-Pacific ex-Japan	(2.4)	(2.5)	(3.1)	(3.3)	4.3	(22.8)	(52.6)
NAV versus FTSE AW Asia-Pacific ex-Japan	(0.3)	0.6	(1.3)	(0.3)	8.6	(17.7)	(38.3)
Price versus FTSE All-World	(3.6)	(8.7)	(7.0)	(20.5)	(18.6)	(11.0)	28.3
NAV versus FTSE All-World	(1.4)	(5.6)	(5.2)	(17.5)	(14.3)	(5.8)	42.6
Price versus FTSE All-Share	(3.7)	(9.9)	(10.0)	(21.4)	(22.8)	(21.4)	26.3
NAV versus FTSE All-Share	(1.6)	(6.7)	(8.2)	(18.4)	(18.5)	(16.3)	40.7

Source: Thomson Datastream, Edison Investment Research. Note: Data to end January 2014 and indices sterling-adjusted.

As shown in Exhibit 12, the company's NAV total return performance has been virtually in line with the FTSE All-World Asia-Pacific ex-Japan index over one year, ahead over three years and moderately behind over five and 10 years (an annualised NAV total return of 10.3%, compared with the index return of 11.8% pa over 10 years). Turning to risk-adjusted returns, the Sharpe ratios for one, three and five years, of 0.5, 0.4 and 0.9, follow a similar trend to the average for sector investment companies, which were 0.4, 0.5 and 1.2 over the same periods.

Exhibit 13: NAV performance relative to FTSE All-World Asia-Pacific ex-Japan over 10 years

Source: Thomson Datastream, Edison Investment Research

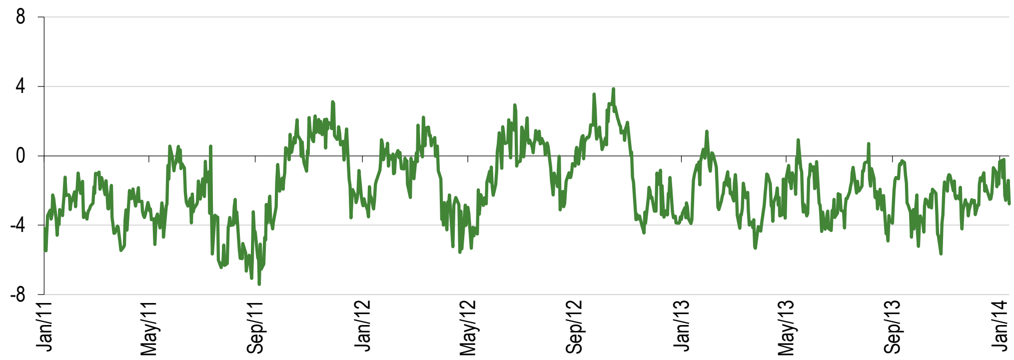
Exhibit 13 shows the company's relative performance over 10 years, highlighting a period of relative weakness in the period leading up to the financial crisis, then outperformance when the crisis was at its worst; this can be attributed to the portfolio's emphasis on cash flow, domestically focused sectors and income growth stocks arguably conferring some quality/defensive characteristics. It was this profile that meant the NAV underperformed again as the market bounced following the crisis. Performance then recovered until taper talk in May 2013 dented performance of stocks in the high-yield portion of the portfolio, followed by a more stable relative performance recently despite weakness in Thailand on the back of serious political instability.

Discount: Trading at a small premium

The board does not have a formal discount control policy or target, but seeks annual authority to buy back up to 14.99% of the shares in issue and to allot new shares. In CY13, with the company trading at a premium for most of the year, the company issued 2.7m shares (2.7% of opening share count) for a consideration of £9.5m. As shown in Exhibit 1, the company has issued shares over the last five years, totalling 26.6m/£75.6m, helping to moderate premium/discount volatility and enhancing NAV.

In the last year the shares have mainly traded at a premium in a range between 0-4%. Given the yield premium the shares offer compared with peers and the steadying of recent relative performance, maintenance of a modest premium seems a reasonable expectation, despite the unsettling effect of volatility in Asian markets in January.

Exhibit 14: Premium/discount over three years (to ex-income NAV)



Source: Morningstar, Edison Investment Research. Note: Negative values indicate a premium.

Capital structure and fees

HFEL has a single class of ordinary shares with 104.6m in issue. The company has an unlimited life and no continuation vote. HFEL has a multi-currency floating rate loan facility of £45m with Commonwealth Bank of Australia (last renewed February 2013). Current net gearing stands at about 6% and the manager believes it would be inappropriate to increase the risk profile by raising gearing significantly, given the company's income mandate.

Following a review, the management fee paid by the trust was reduced from 1.0% to 0.9% pa of the company's net assets (from 1 September 2013). The contract can be terminated without penalty, given at least 12 months' notice. There is no performance fee and the continuing charge for the last financial year (before the fee change) was 1.29%.

Dividend policy

The company pays quarterly dividends. For the last financial year the dividend payable was 17p, an increase of 6.3% and 94% of revenue earnings. Revenue reserves at the year end were equivalent to 67% of the dividend payment after allowing for the payment of the final quarter's dividend. The company aims to move towards having a revenue reserve equivalent to one year's dividend, which we estimate on one set of assumptions[3] could be achieved in three or four years.

Peer group comparison

Exhibit 15 shows performance and other measures for Henderson Far East Income and its Asia-Pacific ex-Japan investment company peers. Among the 14 funds shown, only three have income mandates: HFEL itself, Aberdeen Asian Income and Schroder Oriental Income. Looking at the geographical exposure of the three funds, HFEL is distinguished by a higher exposure to China and Hong Kong and lower allocations to both Singapore and Australia than the other two. In terms of NAV total returns, HFEL ranks ninth, sixth and 13th over one three and five years respectively. As mentioned earlier, the Sharpe ratios for the company have followed a similar pattern to the sector average. It has comfortably the highest dividend yield, which is likely to be the key driver of the small premium to NAV on which the company trades compared with the average discount of 6.8%.

Exhibit 15: Asia-Pacific ex-Japan investment companies peer group

Fund name	Market cap £m	NAV TR one-year	NAV TR three-yr	NAV TR Five-year	Sharpe one-year (NAV)	Sharpe three-yr (NAV)	Discount (ex-par)	Latest ongoing charge	Perf fee	Net gearing ex	NDY (%)
Henderson Far East Income	**314.4**	**-9.2**	**6.6**	**83.4**	**0.5**	**0.4**	**2.1**	**1.3**	**No**	**106.0**	**5.9**
Aberdeen Asian Income	341.5	-11.2	25.7	125.6	0.3	0.9	-3.0	1.3	No	103.0	4.5
Aberdeen Asian Smaller	304.1	-6.6	36.7	220.5	0.5	0.9	-4.6	1.2	No	109.0	1.3
Aberdeen New Dawn	194.3	-11.7	-0.8	120.3	0.2	0.2	-11.3	1.1	No	107.0	2.1
Asian Total Return Inv. Co.	125.6	-15.2	-14.9	93.1	-0.2	-0.1	-3.4	0.9	Yes	98.0	1.9
Edinburgh Dragon	459.1	-12.5	1.6	105.4	0.1	0.2	-11.2	1.2	No	112.0	0.0
Fidelity Asian Values	133.9	0.8	-1.7	119.5	1.1	0.3	-11.6	1.6	No	110.0	0.6
Invesco Asia	135.7	-6.0	1.4	112.2	0.6	0.3	-9.9	1.1	No	104.0	2.1
JPMorgan Asian	185.6	-8.6	-14.2	67.6	0.5	-0.1	-10.4	0.8	Yes	104.0	1.3
Pacific Assets	170.9	-0.8	17.5	128.4	0.6	0.6	-6.4	1.3	Yes	92.0	1.8
Pacific Horizon	119.6	-3.4	-0.5	111.1	0.5	0.2	-10.5	1.2	No	100.0	0.9
Schroder Asia-Pacific	379.8	-12.3	5.3	132.3	0.1	0.4	-10.9	1.1	No	101.0	1.5
Schroder Oriental Income	352.3	-7.3	21.3	168.9	0.4	0.8	-2.4	1.0	Yes	103.0	4.6
Scottish Oriental Smaller Cos	230.9	-2.4	28.1	238.2	0.8	0.7	-7.0	1.0	Yes	95.0	1.6
Average/weighted average	**246.3**	**-8.5**	**10.7**	**134.4**	**0.4**	**0.5**	**-6.8**	**1.1**		**104.0**	**2.3**

Source: Morningstar 29 January 2014. Note: TR = total returns of NAV for investment trusts, TER = total expense ratio. The Sharpe ratio is a measure of risk-adjusted return. The ratios we show are calculated by Morningstar for the past 36-month period 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/cash equivalents as a percentage of shareholders' funds.

The board

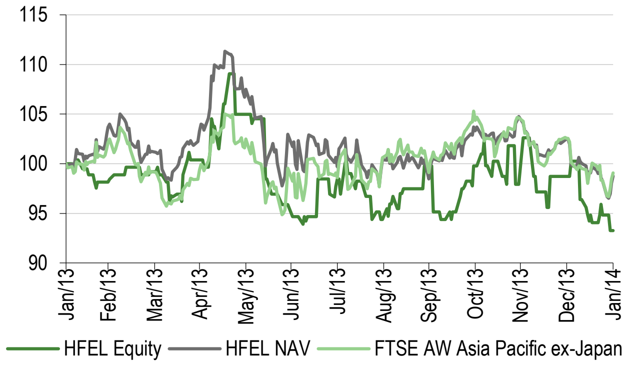
The board (five members, all non-executive and independent of the manager) are John Russell (chairman), David Mashiter, Simon Meredith Hardy, Richard Povey and David Staples. With the exception of David Staples (January 2011), all were appointed in 2006 on formation of the company as a Jersey-domiciled successor to Henderson Far East Income Trust plc (18 December 2006). John Russell and Simon Meredith Hardy were directors of the predecessor company. As noted in the Investment process section (page 6), board members visit Asia once a year, enhancing their ability to provide oversight by refreshing their knowledge of the region and providing insights into companies held in the portfolio. The board plans to visit China this year and has previously visited Singapore, Malaysia, Indonesia and Thailand.

[3] Assumes growth in revenue earnings of 5-7% and HFEL dividends of 4%, a payout ratio of 92% to 90% and no adjustment for the impact of share issuance.

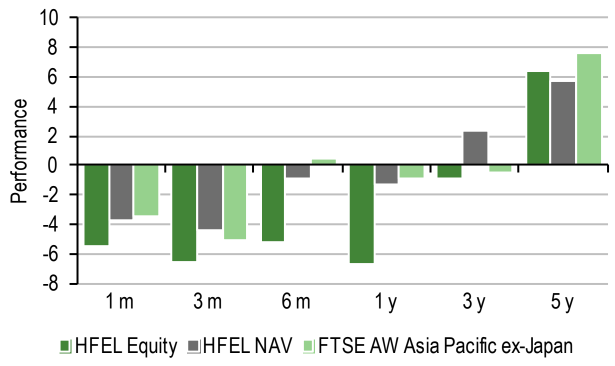
Performance tables in New Zealand dollar terms

Exhibit 16: Investment trust performance – in New Zealand dollar terms

Price, NAV and FTSE All-World Asia-Pacific ex-Japan total return performance, one-year rebased



Price, NAV and FTSE All-World Asia-Pacific ex-Japan total return (%)



Source: Thomson Datastream, Edison Investment Research

The trust's NAV total return performance has been close to the FTSE All-World Asia-Pacific ex-Japan index over one year, ahead over three years and behind over five years, with NAV annualised performance of -1.2%, +2.3% and +5.7% respectively in New Zealand dollar terms. By comparison, the FTSE All-World Asia-Pacific ex-Japan returned -0.9%, -0.5% and +7.7% (see Exhibit 16).

Exhibit 17: Investment trust discrete years performance – in New Zealand dollar terms

12 months ending	Total share price return	Total NAV return	FTSE All-World Asia-Pacific ex-Japan	FTSE All-World	FTSE All-Share
31/01/11	13.4	8.5	14.9	9.5	7.7
31/01/12	(15.1)	(11.1)	(11.5)	(9.4)	(8.1)
31/01/13	22.7	22.0	12.5	13.7	14.9
31/01/14	(6.7)	(1.2)	(0.9)	17.6	18.6

Source: Thomson Datastream. Note: Twelve-month rolling discrete performance. All % total return in NZ$ terms.

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