Henderson Far East Income

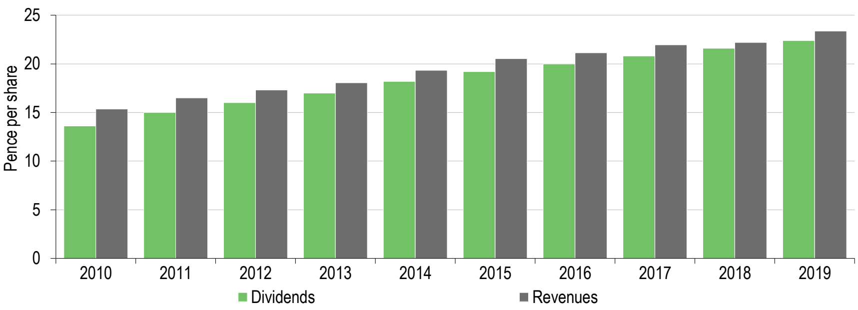
Access to Asian growth with solid 6% yield

Investment trusts
Asia-Pacific equity income

13 January 2020

Henderson Far East Income (HFEL) performed strongly in 2019, unusually outperforming a rising market while continuing to achieve a well-covered dividend and a yield in excess of 6%. The trust, managed by Mike Kerley and Sat Duhra at Janus Henderson Investors, has a relatively concentrated (c 50 stock) portfolio that is split roughly equally between high-yielding stocks and those offering superior dividend growth prospects. Drivers of positive performance during the year included stocks from both sides of the portfolio, with limited impact from the US-China trade dispute given HFEL's focus on domestic rather than export stocks. The managers are optimistic for a recovery in earnings and continued growth of dividends in the Asia Pacific region during 2020.

HFEL has a long record of paying well-covered dividends



Source: Henderson Far East Income, Edison Investment Research

The market opportunity

The Asia Pacific region (particularly its developing markets) continues to enjoy greater economic growth than the rest of the world, which stimulates a growing middle class with higher disposable incomes, driving domestic consumption. While Asian equities are trading above their five-year average forward P/E valuation, they continue to look attractively valued versus the rest of the world.

Why consider investing in HFEL?

- Designed to capture the growing dividend culture in the Asia Pacific region.
- High (c 6%) yield and solid record of annual dividend growth.
- Focus on free cash flow to underpin dividend cover (see chart above).
- Portfolio blends high-yielding companies with those offering superior dividend growth, with the aim of achieving an attractive total return.
- NAV total returns averaging c 8–9% a year over the medium and longer term.

Strong demand keeps shares at a small premium

HFEL's high and well-covered dividend yield of c 6%, together with the potential for capital growth from its portfolio of Asia Pacific investments, has helped its shares to trade consistently at a small premium to NAV (1.5% at 9 January 2020). This compares with average premiums of 1.9%, 1.6%, 0.8% and 1.1% over one, three, five and 10 years. Regular issuance helps meet demand and limit the premium.

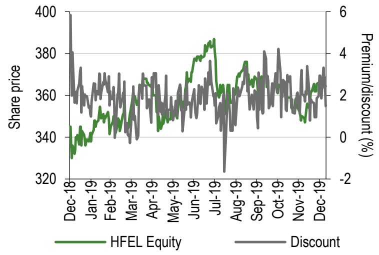
Price	**364.5p**
	NZ$7.20
Market cap	**£494.8m**
AUM	**£480.5m**

NAV*	355.2p
Premium to NAV	2.6%
NAV**	359.2p
Premium to NAV	1.5%

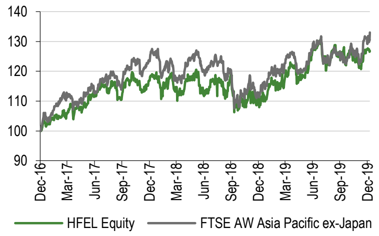
*Excluding income. **Including income. As at 9 January 2020.

Yield	6.1%
Ordinary shares in issue	135.8m
Code	HFEL
Primary exchange	LSE
AIC sector	Asia Pacific – Income

Share price/premium performance



Three-year performance vs index



52-week high/low	387.0p	336.0p
NAV** high/low	379.6p	328.1p

**Including income.

Gearing

Gross*	1.0%
Net*	1.0%

*As at 30 November 2019.

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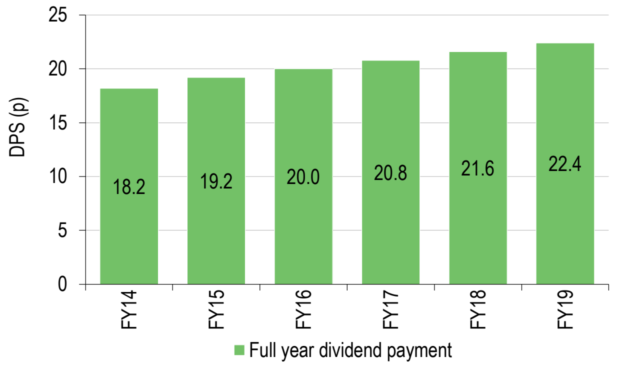
Henderson Far East Income is a research client of Edison Investment Research Limited

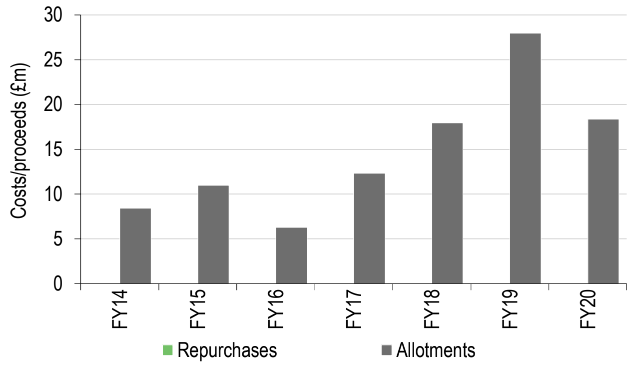
Exhibit 1: Trust at a glance

Investment objective and fund background	Recent developments
Henderson Far East Income aims to provide shareholders with a growing total annual dividend per share, as well as capital appreciation, from a diversified portfolio of investments in the Asia-Pacific region. The fund is classified by the AIC in the Asia Pacific – Income sector and, while it does not have a benchmark, sees the FTSE Asia Pacific ex-Japan index and the MSCI Asia Pacific ex-Japan High Dividend Yield index as appropriate performance comparators.	■ 3 December 2019: EGM to approve allotment of shares in excess of the 10% annual limit. The limit will be reinstated at the January 2020 AGM. ■ 19 November 2019: results for the year ended 31 August. NAV TR +6.5% and share price TR +7.6%, versus +1.7% for the FTSE Asia Pacific ex-Japan index and +2.3% for the MSCI AC Asia Pacific ex-Japan HDY index.

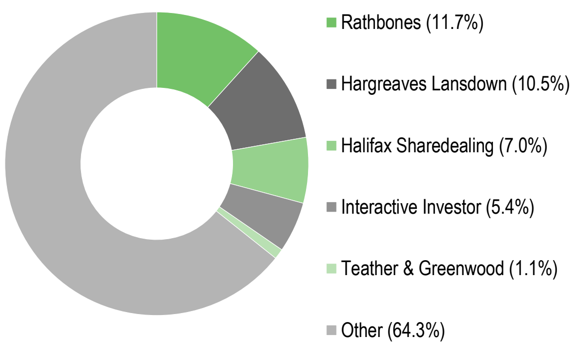
Forthcoming		Capital structure		Fund details	
AGM	January 2020	Ongoing charges	1.11%	Group	Janus Henderson Investors
Interim results	April 2020	Net gearing	1.0%	Manager	Michael Kerley and Sat Duhra
Year end	31 August	Annual mgmt fee	Tiered (see page 9)	Address	201 Bishopsgate, London, EC2M 3AE
Dividend paid	Feb, May, Aug, Nov	Performance fee	No		
Launch date	2006 (as a Jersey co)	Trust life	Indefinite	Phone	+44 (0) 20 7818 1818
Continuation vote	No	Loan facilities	£45m	Website	www.hendersonfareastincome.com

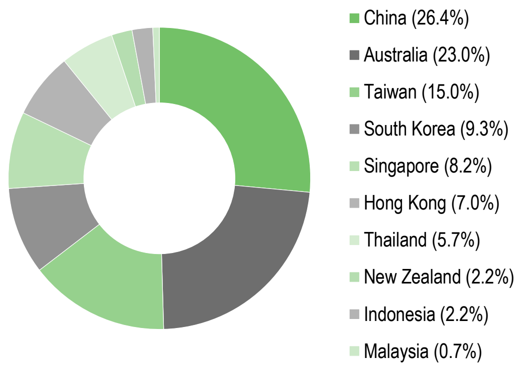
Dividend policy and history (financial years)	Share buyback policy and history (financial years)
Dividends are paid quarterly. The company aims to distribute substantially all its income (after costs) arising in each accounting period.	HFEL is authorised to repurchase up to 14.99% of shares, to hold up to 10% of shares in treasury and to issue up to 10% of shares each year.





Shareholder base (as at 3 December 2019)	FY19 share of income by geography (year ended 31 August 2019)





Top 10 holdings (at 30 November 2019)

			Portfolio weight %	
Company	**Country**	**Sector**	**30 November 2019**	**30 November 2018***
Taiwan Semiconductor Manufacturing	Taiwan	Technology	4.0	2.5
Macquarie Group	Australia	Financials	3.3	2.5
Samsung Electronics	South Korea	Technology	3.0	2.0
Macquarie Korea Infrastructure Fund	South Korea	Financials	3.0	2.9
Sands China	China	Consumer services	2.9	N/A
Treasury Wine Estates	Australia	Consumer goods	2.8	1.5
Digital Telecoms Infrastructure Fund	Thailand	Telecoms	2.8	2.6
HKT Trust & HKT	Hong Kong	Telecoms	2.8	3.0
Mapletree Commercial Trust	Singapore	Property	2.7	2.2
China Yangtze Power	China	Utilities	2.7	2.5
Top 10 (% of holdings)			**30.0**	**27.5**

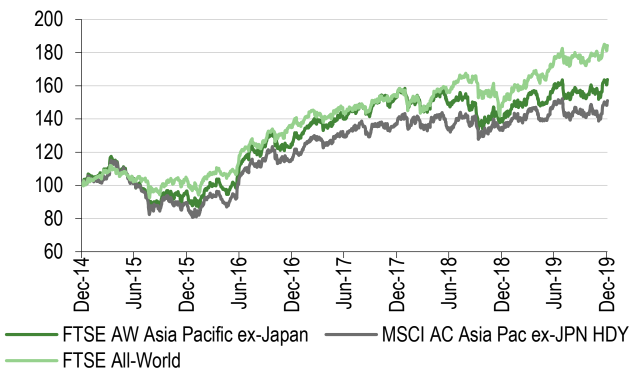
Source: Henderson Far East Income, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-November 2018 portfolio.

Market outlook: Relative value in Asia

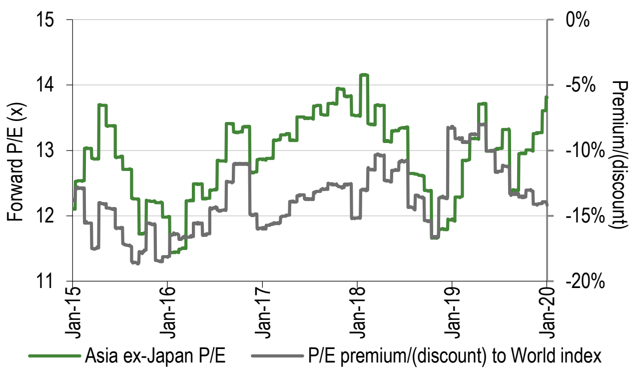
Asia Pacific equity markets have lagged the broad global index over the past five years (Exhibit 2, left-hand chart), as the global market is heavily dominated by the US, which has enjoyed a decade-long bull run and continues to test all-time highs. Yet there remain compelling reasons to invest in Asia, which enjoys a higher rate of economic growth, leading to a growing middle-class population with rising disposable incomes. Although the Datastream Asia ex-Japan index forward P/E is above its five-year average (right-hand chart), at 13.8x versus an average of 12.9x, this is a c 14% discount to the 16.1x forward P/E valuation of the Datastream World index, suggesting there is still relative value to be found. However, global geopolitical worries still loom large and although the US and China seem close to an initial agreement to end their trade dispute, recent US military action in Iran has the potential to cause a global oil shock. In such an environment, investors with an eye on total returns may wish to consider allocating to a fund with the underpinning of a high and well-covered dividend yield, as near-term share price appreciation may be limited.

Exhibit 2: Market performance and valuation

Broad and high-yield Asia Pacific indices versus FTSE All World



Asia ex-Japan 12m forward P/E and versus World index



Source: Refinitiv, Edison Investment Research. Note: Valuation data at 7 January 2020, using Datastream indices.

Fund profile: Unconstrained Asian income specialist

HFEL was set up in 2006 as a Jersey-incorporated successor vehicle to the onshore Henderson Far East Income trust. At the time this meant the fund received more favourable tax treatment on its overseas dividends; however, changes in the UK tax regime mean this is no longer the case and in 2019 HFEL relocated its tax residence and became an investment trust under UK law. The trust aims to achieve a high and growing income, as well as capital growth, by investing across the Asia Pacific region. To achieve its income aims, HFEL's portfolio is split roughly 50:50 between high-yielding stocks and those with superior dividend growth prospects.

The trust's shares are listed in London and on the New Zealand Stock Exchange. HFEL has no official benchmark, although it measures its performance with reference to the FTSE Asia Pacific ex-Japan index and the MSCI AC Asia Pacific ex-Japan High Dividend Yield index. While both these indices exclude Japan, HFEL has no restrictions on country and sector weightings and may invest in Japan, although in practice this is likely to be limited. Portfolio construction is largely bottom up and the only significant investment restriction is that no company may make up more than 10% of the total portfolio. The trust is a member of the Association of Investment Companies' Asia Pacific – Income sector. To meet the requirements of the sector, HFEL must invest at least 80% of its assets in the shares of companies that are listed in, registered in, or whose principal business is in the Asia-Pacific region. It may also hold warrants, debt securities and equity-related securities, such as pre-IPO stocks that are expected to list shortly. The manager may write put or call options to generate additional income through premiums and the trust is permitted to gear up to 30% of gross assets. Net gearing was 1% at end-November 2019.

The fund managers: Mike Kerley and Sat Duhra

The manager’s view: A more positive outlook for 2020

Commenting on a strong year for HFEL’s NAV performance (+16.1% in calendar 2019), Kerley said that two things worked particularly in the trust’s favour. Firstly, the US Federal Reserve’s pivot from a tightening to a loosening bias in early 2019 was very positive for income stocks; the manager notes that during that period, the high-yield part of HFEL’s portfolio (particularly telecom stocks and REITs) unusually outperformed a rising market, while consumer stocks (which are more on the dividend growth side) also outperformed. The other main driver was HFEL’s domestic focus; with little exposure to exporters, the portfolio was largely insulated from the destabilising effects of the US-China trade dispute.

On the income side, the manager says underlying dividend growth was positive in 2019 and there were more companies paying special dividends, including some quite large ones from resources stocks BHP Group and Rio Tinto. Dividend surprises have also come from property developers (although not so much from REITs, as they are already high yielding). However, Kerley notes that dividend growth in Asia came in better than earnings growth, which ended up at less than 4% for the year. ‘From 2010 to 2017 there was effectively no earnings growth in Asia’, he adds. ‘Everyone had high expectations and they ended up disappointed. But now earnings growth expectations – except in South Korea – have turned less negative, which is encouraging’. The manager explains that while business expectations in Korea are very good for next year, this is yet to feed through into the consensus earnings numbers. ‘The Korean market is very large and it is seen as an indicator of global growth’, he adds.

While the rate of GDP growth is slowing in Asia, in absolute terms it is still above the rest of the world. However, Kerley says that a pick-up in Asian earnings growth no longer rests on global economic growth. ‘China is so big now that Asia can almost be self-sustaining from an economic standpoint, and there is now more intra-regional trade than international – for example, 50% of Korea’s exports are to China. Globalisation is now a regionalisation story, with manufacturing moving from China to Vietnam, Cambodia and Laos as they are lower cost’. However, he adds that it is harder for Asia to be self-sustaining financially, as market direction is influenced by fund flows, whether that is foreign direct investment or financial investment.

‘Most people who invest in Asia are tourists’, says Kerley. ‘They come when growth is higher than the rest of the world and leave when it is lower, so at the moment they are allocating to us, as growth is higher. In recent years only the US has really seen earnings growth, but half of that is share buybacks, so it is low quality and I don’t think it can be sustained. Earnings growth appears to have bottomed in most Asian markets (excepting Korea and India), and there is some fiscal and monetary headroom, so the environment is perfect for Asia to do better than other markets – valuations are in our favour and growth should be in our favour too, so we are a bit more positive on the outlook for next year than we were for 2019’.

Asset allocation

Investment process: Asian growth with value and income focus

HFEL was designed to pick up the change in dividend culture in Asia versus the rest of the world, which has gathered pace since the trust’s launch in 2006. It uses a consistent and disciplined approach to build a portfolio of c 40–60 stocks from across the Asia Pacific region. HFEL’s managers

– Mike Kerley in London and Sat Duhra in Singapore, supported by analyst James Zhang – aim to provide an attractive total return, with a relatively even split between high-yielding stocks and those with superior dividend growth prospects. ‘If you are in Asia for income, you want what the rest of the world doesn’t have, and that is growth’, comments Kerley. The managers seek cash-generative companies with good growth prospects, trading at valuations that suggest the market is underrating the value of their future cash flows.

Investment ideas come from a combination of quantitative screening (seeking companies with high yields and/or high dividend growth), country and company visits, and the use of industry research. The team will meet with the management of potential investee companies, to understand the business drivers and key risks, and proprietary models are built, focusing on cash flow generation, to establish a target price range. HFEL tends not to own sub-$1bn companies but has a bias towards mid-cap ($3–10bn) stocks. Kerley says the portfolio is underweight mega-caps, which tend to be expensive and may not pay dividends. The team generally does not buy non-yielding companies, although some holdings may have relatively low yields in the 1–2% range. ‘We like a company to commit to some kind of dividend policy so we can forecast out. You want dividends to reflect the underlying earnings growth of a company over time’, Kerley explains.

Exhibit 3: HFEL portfolio metrics versus indices at 31 October 2019

Metric	HFEL	FTSE Asia Pacific ex-Japan index	MSCI AC Asia Pacific ex-Japan HDY index
Price/book (x)	1.5	1.6	1.2
P/E 12m forward (x)	12.8	13.5	9.9
Dividend yield (%)	4.8	3.0	5.0
Dividend yield est 12m forward (%)	5.1	3.1	5.0
Free cash flow yield (%)	7.4	5.9	7.9
Return on equity (%)	16.8	16.0	15.6

Source: Henderson Far East Income, Edison Investment Research

HFEL’s focus on finding attractively valued, income-generating companies means that its holdings tend to trade on lower average P/E and price/book multiples than the broad FTSE Asia Pacific ex-Japan index, as well as having higher dividend yields (Exhibit 3). The forecasts in the table are based on consensus numbers; HFEL’s own forecast for its portfolio dividend yield in 12 months’ time is higher, at 6%. Kerley explains that the team looks for the likelihood of dividend surprises, with some recent examples including Taiwan Cement, whose 2019 dividend was 106% higher than forecast, and Hong Kong jeweller Chow Tai Fook, whose payout last year beat expectations by 119%. The high free cash flow yield on the portfolio (at 7.4%, versus 5.9% for the FTSE index) gives the manager reassurance on the sustainability of dividends.

All holdings are assigned a target price and are usually sold once this is reached. The team uses option-writing to enhance income and may write a call option on a stock that is nearing its target price. HFEL’s portfolio is constantly monitored against risk and style metrics as well as country and industry fundamentals. Portfolio turnover in FY19 was c 65%, which was somewhat lower than the c 88% average of the previous five financial years.

Current portfolio positioning

At 30 November 2019, there were 44 positions (including one option) in HFEL’s portfolio, compared with 52 a year earlier. While not quite equally weighted, the vast majority of HFEL’s positions are between 2% and 3% of the portfolio. The top 10 holdings made up 30.0% of the total, a slight increase in concentration compared with 27.5% a year earlier.

Over the past 12 months, the largest change in country weighting has been a 5.3pp reduction in China (Exhibit 4), partly due to the sale of the position in Anta Sports Products and profit taking in Kweichow Moutai. The weighting in South Korea has fallen by 2.6pp, while Taiwan and Indonesia have increased by 2.7pp and 2.6pp respectively. With the exception of the ‘other’ category, where the 10.5pp underweight versus the FTSE Asia Pacific ex-Japan index is largely accounted for by a lack of exposure to India (9.1% of the index), China is the largest underweight position, at -9.6pp, while Singapore (+7.5pp) and Thailand (+5.8pp) are the largest overweights. However, China remains the largest absolute country position, with a mix of high yield and dividend growth stocks. Kerley has holdings in some state-owned companies – such as China Mobile, China Construction Bank and China Petroleum and Chemical (Sinopec) – as well as aspirational consumer brands. Australian holdings are mainly in higher-yielding areas such as real estate, utilities and basic materials, although the largest position in Australia is Treasury Wine Estates, a wine producer with significant exposure to the growing Chinese market.

Exhibit 4: Portfolio geographic exposure vs FTSE Asia Pacific ex-Jp index (% unless stated)

	Portfolio end-November 2019	Portfolio end-November 2018	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
China	20.6	25.9	(5.3)	30.2	(9.6)	0.7
Australia	18.5	17.4	1.1	17.9	0.6	1.0
Taiwan	14.6	11.9	2.7	11.0	3.6	1.3
Singapore	10.7	12.5	(1.8)	3.2	7.5	3.3
South Korea	10.2	12.8	(2.6)	10.9	(0.7)	0.9
Thailand	8.7	8.7	0.0	2.9	5.8	3.0
Hong Kong	6.0	4.7	1.3	9.1	(3.1)	0.7
Indonesia	4.3	1.7	2.6	1.8	2.6	2.5
New Zealand	2.3	2.5	(0.2)	0.8	1.5	3.0
United Kingdom	2.2	1.8	0.4	0.0	2.2	N/A
Vietnam	1.9	0.0	1.9	0.0	1.9	N/A
Other	0.0	0.1	(0.1)	12.4	(12.4)	0.0
	100.0	**100.0**		**100.0**		

Source: Henderson Far East Income, Edison Investment Research

In the past year the team has initiated a position in Vietnam, via the London-listed VinaCapital Vietnam Opportunity Fund (VOF). Kerley says co-manager Sat Duhra spent considerable time with VOF's manager conducting due diligence, 'and we like the fact that 10–15% is in unlisted/pre-IPO stocks'. They chose VOF over its larger peer, Vietnam Enterprise Investments (VEIL) partly because of VOF's lower exposure to Vietnamese banks and because VOF has a dividend policy (paying out c 4% of NAV each year, which may be partly funded out of capital), while VEIL does not pay a dividend. Kerley explains that for foreign investors, who are subject to ownership limits on certain Vietnam stocks, it makes sense to use a closed-end fund to access the market. 'We are getting a 16–17% discount on a portfolio that is probably undervalued and without paying a premium for foreign ownership limit stocks', he says.

Exhibit 5: Portfolio sector exposure vs FTSE Asia Pacific ex-Jp index (% unless stated)

	Portfolio end-November 2019	Portfolio end-November 2018	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Financials	36.7	38.7	(2.0)	31.2	5.6	1.2
Telecommunications	14.7	12.1	2.6	2.9	11.8	5.0
Technology	12.0	8.1	4.0	18.2	(6.2)	0.7
Consumer goods	10.8	12.1	(1.3)	8.3	2.6	1.3
Industrials	8.2	7.9	0.3	9.6	(1.5)	0.8
Oil & gas	6.1	6.7	(0.5)	4.6	1.5	1.3
Basic materials	4.7	8.1	(3.4)	5.8	(1.1)	0.8
Utilities	4.1	4.4	(0.4)	2.8	1.3	1.4
Consumer services	2.7	2.0	0.6	12.1	(9.5)	0.2
Healthcare	0.0	0.0	0.0	4.5	(4.5)	0.0
	100.0	**100.0**		**100.0**		

Source: Henderson Far East Income, Edison Investment Research

In sector terms (Exhibit 5), the largest changes over 12 months have been increases in the weightings in technology (+4.0pp) and telecoms (+2.6pp) and reductions in exposure to basic materials (-3.4pp) and financials (-2.0pp). While financials remains the largest absolute sector position and a significant overweight (+5.6pp) versus the FTSE Asia Pacific ex-Japan index, Kerley says the team reduced exposure to banks during 2019. 'We were positive on banks last year on net interest margin improvements in a rising rate environment, but now we expect rate cuts across the region, including in India, Indonesia and China, so the argument is less compelling', he says. 'We have reduced Chinese bank exposure, in Singapore we now only own United Overseas Bank and we still have no Australian bank exposure except Macquarie, which is more of an investment bank'. HFEL has taken on some exposure to Indonesian banks such as Bank Negara, but Kerley explains this is to do with the different dynamics of emerging versus developed markets. 'In developed markets, rate cuts do not make people borrow more, as they are already overleveraged, but they do in emerging markets, so there is an argument for owning emerging market banks in a falling rate environment', he says.

The increases in technology and telecom stocks relate to the team's more positive view on the semiconductor cycle and the demand for 5G networks and associated products. Kerley believes 5G will be different from previous generations, where investment returns have been limited by a lack of differentiation between one generation of technology and the next. 'With 5G you can have an autonomous network, so we think enterprise will use it to a much bigger extent', he explains. 'In areas like "internet of things", you will want your own network. It is a really interesting environment for telcos, as once a corporation signs up to their own 5G network, they are unlikely to move'. The manager adds that on the hardware side, 5G should be positive for infrastructure-related companies, while tech equipment manufacturers should also benefit from the transition. 'I think telecoms could actually become a growth sector, but we also like memory, foundry and underlying hardware, so among other things we have increased the weighting in Samsung', says Kerley.

As well as the new position in VOF, recent purchases include China Resources Cement (CRC). Kerley says the team likes the Chinese cement sector, as infrastructure spending is robust and property demand is strong, but environmental pressure is cutting the supply of inefficiently produced cement, meaning efficient operators can command a higher price for their products. HFEL had previously had a position in another high-quality and efficient producer, Anhui Conch Cement, but Kerley says the company's shares became expensive, while CRC is smaller and cheaper, at a P/E valuation of c 6x and with a 4.5–5.0% dividend yield.

Also added to the portfolio in recent months is Yageo, a Taiwanese company that makes ceramic capacitors. When HFEL initiated the position in July 2019, Yageo had a 16.5% dividend yield. Since then the share price has gone up by more than 60%, but the yield is still very attractive at over 10%. Kerley explains that capacitors are a commodity product, which had been in oversupply, and as inventories normalised, it only needed a small increase in the price of components for Yageo to see a significant positive earnings impact because of operating leverage.

Performance: A strong year in a rising market

Exhibit 6: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	FTSE Asia Pacific ex-Japan (%)	MSCI AC Asia Pac ex-Jpn HDY (%)	FTSE All-Share (%)
31/12/15	(5.7)	(4.5)	(3.5)	(10.4)	1.0
31/12/16	26.1	23.5	28.7	28.9	16.8
31/12/17	16.9	18.5	23.4	18.7	13.1
31/12/18	(3.4)	(7.1)	(8.5)	(1.5)	(9.5)
31/12/19	12.7	16.1	14.5	9.9	19.2

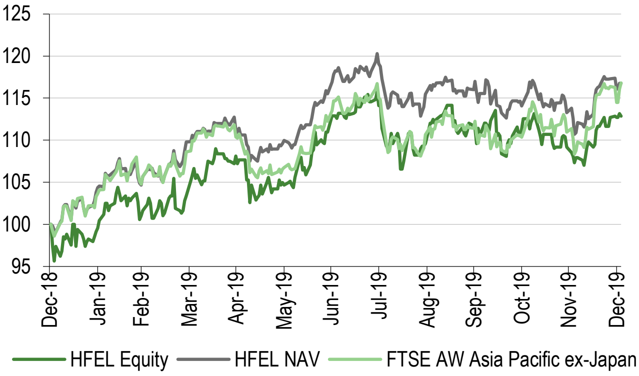
Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

HFEL saw a strong period of NAV performance in 2019, outpacing both the broad FTSE Asia Pacific ex-Japan index and MSCI AC Asia Pacific High Dividend Yield index. Kerley says he would normally expect the trust's performance to sit between that of the broad index (which includes the non-dividend paying but high-growth Chinese internet giants) and the high-yield index (which may include stocks whose yields are high because their share prices have fallen a long way). Therefore, it is notable that HFEL has outperformed the broad index in a generally rising market. It also beat the FTSE index in 2018, a period that included a sharp sell-off in the last quarter (Exhibit 6).

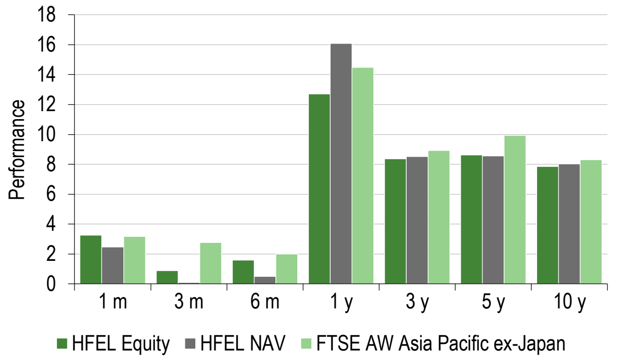
However, over three, five and 10 years, the trust has slightly lagged, with NAV and share price returns of c 8–9% a year versus c 8–10% for the broad index (Exhibit 7, right-hand chart).

Exhibit 7: Investment trust performance to 31 December 2019

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



Price, NAV and index total return performance (%)



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

For the 12 months to 31 October 2019, Kerley says the positive contributors to performance were two pronged – some traditional high-yield names in areas such as infrastructure and telecoms and domestic consumer stocks, particularly in China, where home-grown brands are taking market share from global names. The quality of domestic-branded goods is increasing and rising incomes mean more aspirational purchases, explains the manager. He cites the example of top contributor Kweichow Moutai (now the world's largest distiller), whose high-priced Moutai spirit 'is all about cementing your position in society'. The second best-performing stock, Anta Sports Products, is now China's third-largest sportswear brand and Kerley says it is taking market share from Nike and Adidas, as well as benefiting from a government drive for people to get fitter. 'Nike has c 30% market share in China, Adidas mid-20s and Anta has gone from an 8% to a 15–16% market share', the manager says, adding that Anta has bought Finnish firm Amer Sports, which owns the winter sports brand Salomon. He argues the purchase is well timed given the Winter Olympics is in China next year. 'We are starting to see these brands growing overseas now as well as in China', he adds. Following the strong performance of these two companies, the position in Kweichow Moutai has been trimmed, while Anta Sports has been sold completely. 'It went up so much that we couldn't justify the valuation and the dividend yield went from 2.0% to 1.5%', says Kerley.

Away from Chinese consumer stocks, good performance also came from stocks including Mapletree Commercial Trust (a Singapore REIT), which the manager says 'is not growing much but the yield is high', and Digital Telecommunications Infrastructure Fund, which owns telecom towers in Thailand. 'The positive contributors have been a real mix of high yield and dividend growth', the manager explains.

On the negative side, Kerley says, 'anything in oil or petrochemicals has been a struggle'. Cyclical sectors in general have lagged, although cement has held up well (Taiwan Cement was one of the top 10 positive contributors) as it is priced domestically rather than internationally. 'If the yield curve steepens, the market will move from growth towards value and cyclicals', the manager explains. 'Things like chemicals and refining have lagged turnaround expectations, so we hold on as a hedge against the rest of the portfolio, where we do still have some exposure to quality growth stocks'. The three largest detractors from performance – SK Innovation, Sinopec and Indorama Ventures – are all petrochemical stocks and remain in the portfolio on the expectation of a cyclical upturn.

Exhibit 8: Share price and NAV total return performance, relative to indices (%)

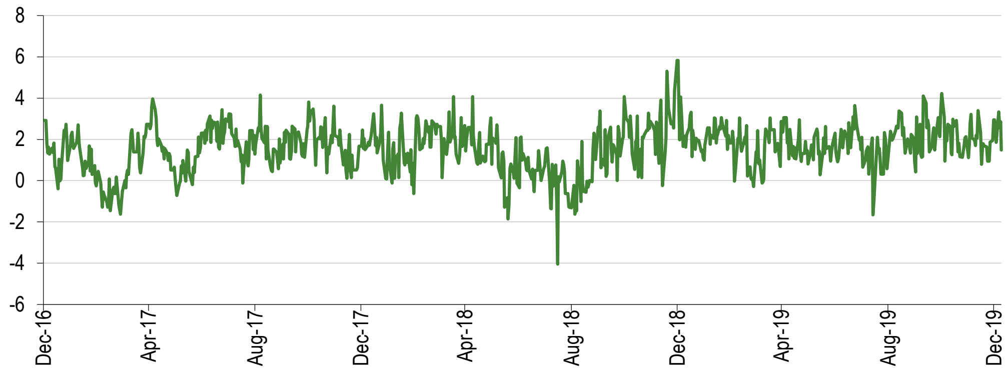
	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to FTSE AW Asia Pacific ex-Jp	0.1	(1.8)	(0.4)	(1.5)	(1.5)	(5.8)	(4.0)
NAV relative to FTSE AW Asia Pacific ex-Jp	(0.7)	(2.6)	(1.5)	1.4	(1.1)	(6.1)	(2.4)
Price relative to MSCI AC Asia Pac ex-Jp HDY	(1.5)	(1.9)	1.0	2.6	(0.9)	2.0	(9.1)
NAV relative to MSCI AC Asia Pac ex-Jp HDY	(2.3)	(2.7)	(0.0)	5.6	(0.5)	1.7	(7.6)
Price relative to FTSE All-Share	(0.1)	(3.1)	(3.7)	(5.4)	4.3	5.1	(2.5)
NAV relative to FTSE All-Share	(0.8)	(3.9)	(4.7)	(2.6)	4.7	4.8	(0.9)

Source: Refinitiv, Edison Investment Research. Note: Data to end-December 2019. Geometric calculation.

Discount: Retail demand keeps shares at a premium

HFEL's shares have traded fairly close to NAV since launch and stood at a 1.5% premium to cum-income NAV at 9 January 2020. This compares with an average premium of 1.9% over the past 12 months and longer-term average premiums of 1.6%, 0.8% and 1.1% over three, five and 10 years, respectively. As noted in the capital structure and fees section, the board regularly issues shares to help meet excess demand. Kerley reports that many of the newly issued shares are being bought through execution-only platforms by retail investors, with platforms now making up three of the top four shareholders (see Exhibit 1).

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



Source: Refinitiv, Edison Investment Research

Capital structure and fees

Incorporated in Jersey in 2006 as a closed-end investment company, HFEL moved its tax residence to the UK during FY19 and joined the investment trust regime. The UK has more double taxation agreements in place than Jersey, so the move was made to access lower rates of withholding tax on some overseas investments. HFEL has one class of share, with 135.8m shares in issue at 9 January 2020. The trust has authority, renewed annually, to repurchase up to 14.99% of its shares or allot up to 10% to manage a discount or a premium. Since the FY18 AGM, 11.8m shares (9.5% of the share base) have been issued, raising £42.2m. Because this was nearing the 10% limit, in December 2019 an extraordinary general meeting was held to approve the ability to allot up to an extra 5% until the FY19 AGM in January 2020, when the 10% authority will be proposed for another year. While HFEL is permitted to use gearing of up to 30% of gross assets, in practice it has tended to gear only to a limited extent. Borrowing is via a £45m multicurrency bank loan, which equates to maximum available gearing of c 9% of net assets. Actual net gearing at 30 November 2019 was 1%, compared with a 12-month range of 0% to 3%.

Henderson Investment Funds, HFEL's Alternative Investment Fund Manager (AIFM) under the AIFM Directive, receives an annual management fee on a decreasing scale of 0.90% of net assets up to £400m and 0.75% thereafter. There is no performance fee. Ongoing charges for FY19 were 1.11%, a marginal increase on 1.09% in FY18.

Dividend policy and record

HFEL pays dividends quarterly, in February, May, August and November. Dividends per share have increased annually since the trust's launch (in spite of a significant expansion in the share base) and have been fully covered by income, including option premiums, each year (see front-page chart for the last 10 years' revenues and dividends per share). Total dividends for FY19 amounted to 22.4p per share on revenue returns per share of 23.4p (FY18: 21.6p and 22.2p). The 3.7% increase in the dividend was lower than the 5.3% increase in revenues, with the board choosing not to pass on the full increase to safeguard future dividend growth and in recognition of the fact that a yield above 6% is already very attractive. Dividends have grown at a compound 4.2% a year over the last five years, which is above the rate of UK CPI inflation. During the year, £1.4m was added to HFEL's revenue reserve, which stood at £25.0m (19.1p per share) at the year-end, or 0.85x the FY19 annual dividend.

Peer group comparison

In 2019 the Association of Investment Companies set up a new Asia Pacific – Income sector to aid comparison of Asia Pacific funds that seek income as well as capital growth. The four funds in the sector are shown in Exhibit 10; however, it is worth noting that one of the peer group, JPMorgan Asian, achieves its yield partly through return of capital, while the others target a fully covered dividend from a portfolio of income-generating stocks. HFEL is the second largest of the four funds and ranks second in performance terms over one and three years (over five and 10 years it ranks third and fourth, respectively). Ongoing charges are above average, but there is no performance fee, unlike Schroder Oriental Income, which has a lower ongoing charge but does have a performance fee. Two peers currently trade at a premium and two at a discount to NAV; HFEL's 2.5% premium is the highest, perhaps owing to its well-covered 6.1% dividend yield, which is 1.5pp above the sector average. Gearing is modest at 1%, below the 4% average for the group.

Exhibit 10: AIC Asia Pacific – Income sector as at 3 January 2020*

% 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
Henderson Far East Income	**495.1**	**17.1**	**28.5**	**49.0**	**116.7**	**1.11**	**No**	**2.5**	**101**	**6.1**
Aberdeen Asian Income	381.8	12.7	23.2	43.1	157.6	1.11	No	(6.7)	108	4.3
JPMorgan Asian	371.6	19.7	54.7	86.8	143.9	0.75	No	(5.3)	100	4.0
Schroder Oriental Income	693.2	15.9	24.3	60.3	208.0	0.86	Yes	0.6	106	3.9
Sector average (4 funds)	**485.4**	**16.3**	**32.7**	**59.8**	**156.6**	**0.96**		**(2.2)**	**104**	**4.6**
HFEL rank in sector	**2**	**2**	**2**	**3**	**4**	**1=**		**1**	**3**	**1**

Source: Morningstar, Edison Investment Research. Note: *Performance to 2 January 2020 based on ex-par NAV. TR=total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared).

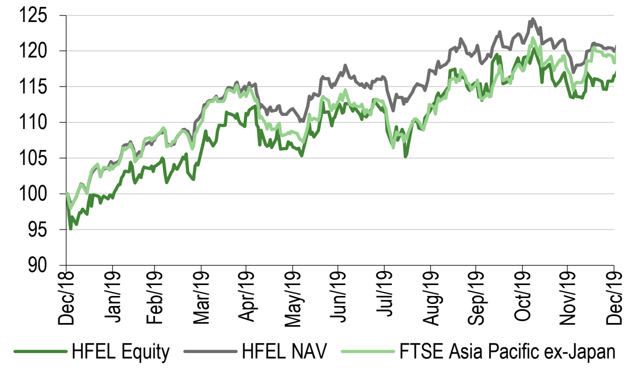
The board

HFEL's board is made up of five independent, non-executive directors. The chairman, John Russell and David Mashiter have both served on the board since the trust's launch in 2006. Mashiter will step down in 2020, while Russell intends to retire in 2021. The other directors are Julia Chapman (appointed in 2015), Nicholas George (chairman of the audit committee, appointed in 2016) and Tim Clissold (appointed in 2018). Mashiter and Chapman are both resident in Jersey and the board is seeking another Jersey-resident director to replace Mashiter on his retirement. The directors all have professional backgrounds in financial services and several have lived and worked in the Asia Pacific region.

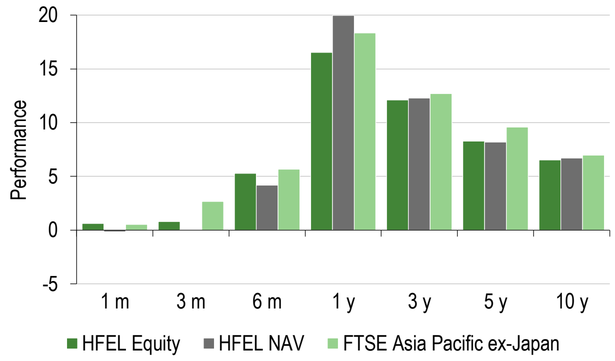
Performance tables in New Zealand dollar terms

Exhibit 11: Investment trust performance – in New Zealand dollar terms to 31 December 2019

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



Price, NAV and benchmark total return performance (%)



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

HFEL retains a secondary listing on the New Zealand Stock Exchange and in Exhibits 11 and 12 we present its performance and that of the FTSE Asia Pacific ex-Japan index in NZ dollar (NZD) terms. Although a strengthening in sterling in September and October limited gains at the underlying portfolio level (see Exhibit 7), it boosted returns for NZD investors over the last six months, while sterling-based investors saw higher returns in December. NAV total returns have also been higher for NZD investors over one and three years (while sterling has been weak in a global context since the UK's EU referendum in 2016, the NZD has been even weaker), but are broadly similar over five years and lower over 10 years to end-December.

Exhibit 12: Investment trust discrete years' performance in New Zealand dollar terms

12 months ending	Share price (%)	NAV (%)	FTSE Asia Pacific ex-Japan (%)	MSCI AC Asia Pac ex-Jpn HDY (%)	FTSE All-Share (%)
31/12/15	1.8	3.0	4.2	(3.3)	9.0
31/12/16	3.8	1.7	5.9	6.1	(3.9)
31/12/17	25.4	27.2	32.4	27.4	21.4
31/12/18	(3.6)	(7.2)	(8.6)	(1.7)	(9.6)
31/12/19	16.5	20.0	18.4	13.6	23.2

Source: Refinitiv. Note: Total return basis, in NZ dollar terms.

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