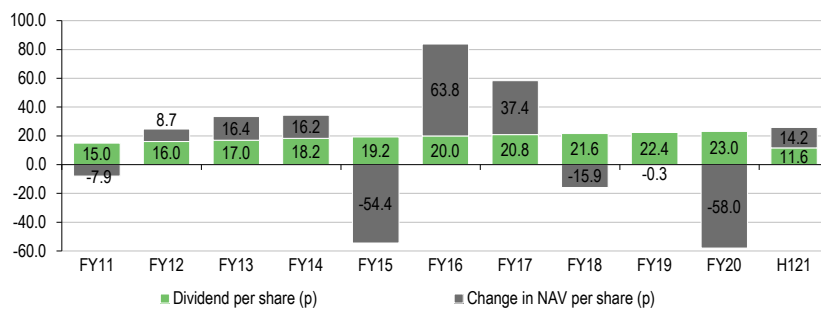


Henderson Far East Income

Consistently high and growing income

Henderson Far East Income (HFEL) continues to reward its investors with a high, rising and fully covered income from a relatively concentrated (c 45 holdings) portfolio of stocks from across the Asia Pacific region. Managers Mike Kerley and Sat Duhra see good opportunities in banks and materials stocks, both of which are set to benefit from the expected economic recovery as the region and the wider world look ahead to life after the pandemic stage of COVID-19. Although recent returns have been relatively muted (given large gains in areas such as Australian banks, which the managers felt were unattractive from an income perspective), Kerley sees strong earnings growth expectations for the region as eminently achievable, which should support further dividend growth.

HFEL offers high and rising income with capital growth potential



Source: Henderson Far East Income, Edison Investment Research

Why invest in Asia for income now?

Dividend culture has become far more embedded in Asian financial markets over the past two decades and the region offers a dividend yield slightly above that of the world equity market (using Datastream indices). Given the prominence of high-growth, low-yielding internet companies among Asia's (and particularly China's) biggest names, it is clear that beneath this average number there are many higher-yielding companies. This could point to attractive total return opportunities for investors, given that much of Asia enjoys higher rates of economic growth than the West, in many cases aided by a young and increasingly affluent population.

The analyst's view

HFEL is a fund that 'does what it says on the tin', offering investors a high and growing yield from a portfolio of companies across the Asia Pacific region. As shown in the chart above, its dividends (always fully covered to date, even in FY20) have provided a consistent return, which has only been negated by capital losses in two of the past 10 years, leading to an average annual total return of c 7% over the decade to 30 June 2021. With a yield of 7.2%, the trust only needs to stand still in capital terms to keep up this average; however, its focus on less COVID-affected North Asian markets and the prospect of a continued shift in market focus towards more economically sensitive and higher-yielding stocks holds out the prospect of a superior total return. HFEL's shares consistently trade at a small premium to NAV, suggesting it has a loyal following.

NOT INTENDED FOR PERSONS IN THE EEA

Investment trusts
Asia Pacific equity income

23 July 2021

Price 322.0p
NZ\$6.45
Market cap £483.7m
AUM £460.9m

NAV* 313.5p
Premium to NAV 2.7%

*Including income. At 21 July 2021.

Yield 7.2%
Ordinary shares in issue 150.2m
Code/ISIN HFEL/JE00B1GXH751
Primary exchange LSE
AIC sector Asia Pacific Equity Income
52-week high/low 343.0p 286.5p
NAV* high/low 336.0p 289.1p

*Including income

Gross gearing* 8.0%
Net gearing* 4.0%

*At 30 June 2021

Fund objective

Henderson Far East Income aims to provide shareholders with a growing total annual dividend per share and capital appreciation, from a diversified portfolio of investments in the Asia-Pacific region.

Bull points

- Access to Asian growth with an income discipline, which can limit volatility.
- Consistently high dividend yield, currently over 7%, comparing well with other income assets.
- To date, dividends have been fully covered by income and the trust has a healthy revenue reserve (0.55x the annual dividend at end-H121).

Bear points

- Total returns have lagged those of lower-yielding peers over recent times.
- Focus on income-generating stocks means a lack of exposure to some higher-growth areas.
- Very high weighting to financials and real estate (c 45%) arguably adds risk, although there is a decent level of diversity at the stock level.

Analysts

Sarah Godfrey +44 (0)20 3681 2519
Mel Jenner +44 (0)20 3077 5700

investmenttrusts@edisongroup.com

[Edison profile page](#)

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

The fund managers: Mike Kerley and Sat Duhra

The manager's view: Reaping the rewards of recovery

The HFEL team has reacted to the expectation of post-COVID-19 economic recovery by increasing positions in banks and materials stocks, as well as maintaining a healthy weighting in the more income-generative areas of technology. Kerley says it was difficult to capture the early stages of the market rotation towards more value and cyclical stocks that began late in 2020 on news of positive COVID-19 vaccine trials, given many of the companies whose share prices rallied most sharply were not attractive from an income perspective. 'Australian and Singapore banks have benefited from the expectation of economic recovery, but their dividends (which they were forced to cut by regulators) will probably not return for several years,' he explains. The rotation saw share prices bounce back to pre-pandemic levels, but with their dividends down by c 40%, Kerley says they looked expensive, adding 'we have found more interesting opportunities in other banks, mainly in China but also Taiwan and Korea'.

The North Asian bias of these purchases is echoed across the portfolio, given the continued impact of new coronavirus infections in South and South East Asia. 'Our initial view was that we needed to focus on North Asia in the early part of the year and look south later as economies reopened, but the COVID-19 situation in South Asia is getting worse, not better, so that is pushing out our recovery expectations for India and ASEAN into next year,' the manager comments.

Kerley says North Asian banks offer an attractive combination of high starting yields and good potential growth in earnings and dividends. 'Consensus is for c 35% earnings growth across the region in 2021; banks will probably achieve half the market average, but I would still consider them a growth sector, and with a 6% dividend yield I would take that any day,' he argues. Looking at other sectors, the manager comments that energy (forecast earnings +80%), industrials (+70%) consumer discretionary (+60%) and materials (+55%) are all expected to grow strongly, while the laggards are consumer staples, utilities and real estate, which did not suffer as much of a pandemic hit last year. 'I think these numbers are achievable as it is coming from a low base,' he says. Furthermore, this is not just a story of mean-reversion after a major fall, with forecast earnings set to outstrip 2018 numbers by a double-digit margin. (Comparing earnings growth to 2018 levels is a more challenging target than 2019, which was a lacklustre period that saw earnings fall year-on-year.) Earnings growth should feed through into dividend growth (which, excluding Australia and New Zealand, was marginally positive across Asia ex-Japan even in 2020), with consensus forecast growth versus 2018 of 27.6% in 2021 (again excluding Australasia) whereas UK dividends are still expected to be down 17% on pre-pandemic levels. Although the human cost of COVID-19 on life and individual freedom has been enormous, Kerley says the pandemic's impact on companies in Asia has been minimal: 'it has had far less impact than the global financial crisis, when there was financial contagion. The economic impact of the global financial crisis in Asia wasn't that great but the financial market contagion was huge, and this time it hasn't been.'

Asset allocation

Current portfolio positioning

At 30 June 2021, there were 45 positions in HFEL's portfolio, with the top 10 holdings (Exhibit 1) making up 33.7% of the total, a slight decrease in concentration from a year earlier. Chinese banks and Australian basic materials stocks feature highly among the largest positions, and Kerley notes these areas have the potential to offset the negative impact of any rises in interest rates. 'Income funds can underperform when interest rates rise and the yield differential between equity income

and bonds/cash narrows,' he explains. 'Both banks and materials stocks are beneficiaries of a rising rate environment, so owning these gives us a hedge against any underperformance in the higher-yield part of the portfolio.' That said, monetary policy remains relatively loose across the world as economies continue to grapple with successive waves of COVID-19 infection, so there is little imminent threat of a significant rise in rates. As such, HFEL's exposure to higher-yielding sectors such as telecoms should continue to provide support, with further total return potential coming from more growth-orientated areas like technology (also represented in the top 10 stocks).

Exhibit 1: Top 10 holdings (at 30 June 2021)

Company	Country	Sector	Portfolio weight %	
			30 June 2021	30 June 2020*
China Construction Bank	China	Financials	4.8	4.1
Rio Tinto	Australia	Basic materials	3.9	3.3
BHP Group	Australia	Basic materials	3.8	3.1
Taiwan Semiconductor Manufacturing	Taiwan	Technology	3.5	3.5
Macquarie Korea Infrastructure Fund	South Korea	Financials	3.1	3.1
VinaCapital Vietnam Opportunity Fund	Vietnam	Financials	3.1	N/A
SK Telecom	South Korea	Telecoms	2.9	N/A
Bank of Communications	China	Financials	2.9	N/A
Samsung Electronics	South Korea	Technology	2.9	3.9
Hindustan Petroleum	India	Energy	2.8	N/A
Top 10 (% of holdings)			33.7	35.3

Source: Henderson Far East Income, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-June 2020 top 10.

Although the manager has built up holdings in Chinese banks and software companies (recent purchases in this area include ChinaSoft, Venustech and NetEase), overall exposure to China has declined by more than 10pp over the past 12 months (Exhibit 2), with exits from more highly valued consumer names such as Kweichow Moutai, as well as real estate, infrastructure and entertainment stocks, and some names where sales became necessary as a result of US-imposed sanctions. The position in Singapore has also reduced over the year, following the sale of shopping centre operator Mapletree Commercial Trust. Exposures to Australia, Taiwan, South Korea and Hong Kong have all gone up (partly as a result of recovering share prices), and HFEL's manager has recently initiated a position in Hindustan Petroleum (his first foray into India in some years), which has gone straight into the top 10 holdings.

Exhibit 2: Portfolio geographic exposure vs index (% unless stated)

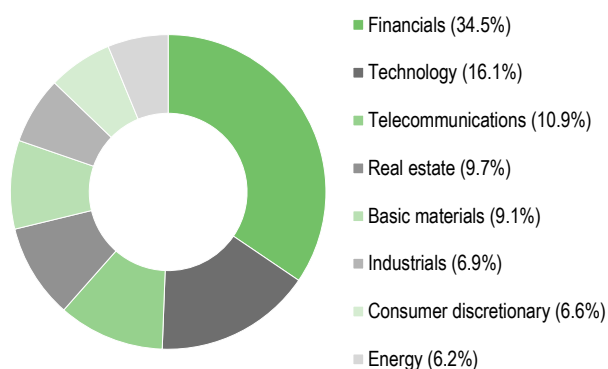
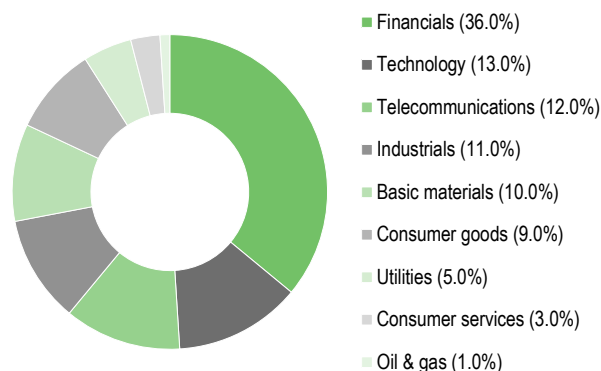
	Portfolio end-June 2021	Portfolio end-June 2020	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/index weight (x)
China	22.6	32.9	(10.3)	34.3	(11.7)	0.7
Australia	19.5	14.4	5.1	14.8	4.7	1.3
Taiwan	17.5	14.0	3.5	13.4	4.1	1.3
South Korea	14.1	9.3	4.8	12.5	1.6	1.1
Hong Kong	11.4	6.4	5.0	6.9	4.5	1.6
Singapore	3.3	6.7	(3.4)	2.3	1.0	1.4
Vietnam	3.1	N/S	N/A	0.0	3.1	N/A
India	2.8	0.0	2.8	10.3	(7.4)	0.3
Indonesia	2.1	2.6	(0.5)	1.0	1.1	2.1
Thailand	1.9	N/S	N/A	1.8	0.1	N/A
United Kingdom	N/S	3.3	N/A	0.0	N/A	N/A
New Zealand	N/S	2.6	N/A	0.6	N/A	N/A
Other	1.8	7.8		2.1		
	100.0	100.0		100.0		

Source: Henderson Far East Income, Edison Investment Research. Note: N/S=not stated; may be included in 'other'. Index is broad Asia Pacific ex-Japan.

Unlike many fund managers at present, Kerley is quite positive on the outlook for oil and gas. Although the sector definitions have changed slightly, energy stocks made up 6.2% of HFEL's portfolio at end-June 2021, compared with just c 1.0% in oil & gas a year earlier (Exhibits 3 and 4). The manager says that regardless of the push towards net zero carbon emissions under the Paris Agreement, demand for oil, gas and to an extent coal will keep going up for at least 10 years, particularly in Asia, so he argues that oil prices are 'pretty well underpinned'. At the same time,

pressure from the environmental lobby means there will be little to no new investment in fossil fuel production, so the combination of minimal capex and higher prices should be very supportive for oil and gas companies to pay higher dividends. As well as Hindustan Petroleum, HFEL has a position in Woodside in Australia; PTT in Thailand was recently sold.

The fund has no exposure to healthcare (a longstanding underweight given the difficulty of finding attractive valued dividend-paying companies in the region), utilities (which performed well in 2020 but look less attractive in an environment combining economic recovery, higher inflation and the prospect of rising interest rates), and consumer staples (another 'defensive' sector where valuations have become stretched). This contrasts with the position a year ago, when there was a combined weighting of c 14.0% in consumer goods (which broadly maps to the new consumer staples definition) and utilities. While the financials weightings (which are substantial and overweight versus both the broad and high-yield indices) appear broadly similar, it is important to note that the old definition included property companies under the umbrella of financials, whereas there is now a separate real estate sector. Taking real estate and financials together, exposure was 44.2% of the portfolio at end-June 2021, compared with 36.0% a year earlier.

Exhibit 3: 2021 portfolio breakdown by new ICB sector

Exhibit 4: 2020 portfolio breakdown by old ICB sector


Source: Henderson Far East Income, Edison Investment Research. Note: Data at 30 June 2021 (Exhibit 3) and 30 June 2020 (Exhibit 4). End-June 2020 sector weightings are approximate.

Performance: Diverse drivers with a tech tilt

Exhibit 5: Five-year discrete performance data

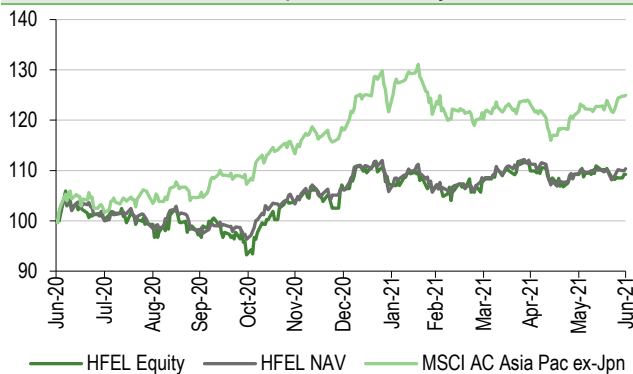
12 months ending	Share price (%)	NAV (%)	MSCI AC Asia Pac ex-Jpn (%)	MSCI AC Asia Pac ex-Jpn HDY (%)	CBOE UK All Cos (%)
30/06/17	31.0	22.6	28.9	25.0	18.3
30/06/18	0.2	2.8	8.1	4.2	9.5
30/06/19	11.2	9.3	4.9	9.4	0.3
30/06/20	(8.2)	(8.5)	2.9	(8.7)	(13.6)
30/06/21	9.2	10.3	24.9	14.5	21.1

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

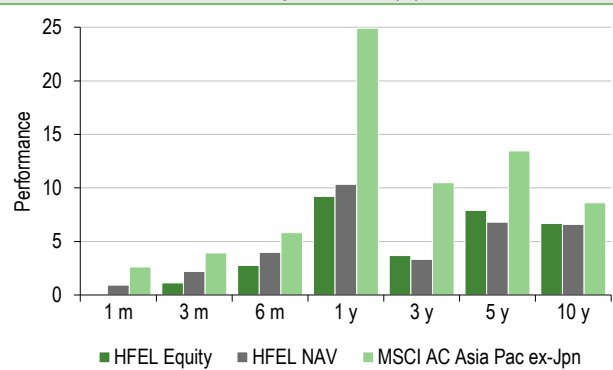
HFEL's NAV and share price total returns over the 12 months to end-June 2021 were positive at c 9–10%, which is ahead of the trust's longer-term average total returns of c 7–8% pa (Exhibit 6) but looks somewhat muted versus stronger one-year performance from both the broad Asian market and the high-yielding subset (Exhibit 5).

Exhibit 6: Investment trust performance to 30 June 2021

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.

The drivers of recent performance have been diverse. While the two biggest positive contributions over 12 months to 31 May 2021 came from technology names Samsung Electronics and Taiwan Semiconductor, HFEL also saw good gains from materials stocks (BHP Group, Rio Tinto and Fortescue Metals) as well as Australian financial group Macquarie and South Korean telecoms operator SK Telecom. LG Corp, Kweichow Moutai (a long-term position, now sold on valuation grounds) and Edison client [VinaCapital Vietnam Opportunity Fund](#) round out the list of top 10 absolute contributors. While Samsung Electronics was the strongest contributor to both absolute and relative performance (versus the broad Asia Pacific index), Korean holding company LG Corp was also prominent in the two lists. Kerley says owning the holding company (which in turn owns listed and unlisted LG group businesses such as LG Electronics, LG Chemical and LG Uplus) gives him access to the underlying growth at a 75% discount to the businesses' aggregate value. Holding companies are an area that is 'massively undervalued and ignored', and the manager also owns Swire Pacific, a Hong Kong-based conglomerate that includes the airline Cathay Pacific as well as a portfolio of Hong Kong property. Swire Pacific was the fourth-largest contributor to relative performance (after Samsung, LG Corp and not owning Chinese online giant Alibaba) over the 12 months to end-May 2021.

On the negative side, the biggest absolute decline came from China Railway Construction, which became subject to US sanctions, with several other Chinese names (sanitary product maker Hengan International, China Resources Cement, state oil company CNOOC [also on the sanctions list] and Bank of China) also among the 10 largest detractors. Kerley says Chinese industrials and non-staple consumer stocks were out of favour in the second half of 2020 despite decent operational performance, as the market focused on tech, healthcare and 'growth at any price'. The remainder of the list was accounted for by companies from Hong Kong (China Overseas Land, telecom operator HKT Trust & HKT, and CK Infrastructure), Thailand (Digital Telecommunications Infrastructure Fund) and Singapore (United Overseas Bank). Six of these names also appear among the 10 largest relative detractors versus the broad index, with five of them (Digital Telecommunications, China Railway Construction, Hengan, China Resources Cement and HKT Trust/HKT) also featuring in the list of biggest detractors versus the MSCI Asia Pacific High Dividend Yield index over the 12 months. Versus the high-yield index, the main positive contributors largely mirror the best performers in absolute terms, given the higher level of crossover between the index and HFEL's portfolio.

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 MSCI AC Asia Pac ex-Jpn	(2.6)	(2.7)	(2.9)	(12.6)	(17.3)	(22.1)	(16.4)
NAV relative to MSCI AC Asia Pac ex-Jpn	(1.7)	(1.7)	(1.7)	(11.7)	(18.2)	(26.0)	(17.1)
Price relative to MSCI AC Asia Pac ex-Jpn HDY	(0.1)	1.6	(4.0)	(4.6)	(2.5)	(1.8)	0.3
NAV relative to MSCI AC Asia Pac ex-Jpn HDY	0.8	2.7	(2.9)	(3.6)	(3.5)	(6.7)	(0.6)
Price relative to CBOE UK All Cos	(0.0)	(4.1)	(7.7)	(9.8)	6.3	7.7	3.0
NAV relative to CBOE UK All Cos	0.9	(3.1)	(6.6)	(8.9)	5.2	2.3	2.1

Source: Refinitiv, Edison Investment Research. Note: Data to end-June 2021. Geometric calculation.

Peer group comparison

HFEL is one of five constituents of the AIC's Asia Pacific Equity Income (formerly Asia Pacific Income) sector. The peers fall into two distinct groups: those that invest specifically for income as well as capital growth (HFEL, Aberdeen Asian Income and Schroder Oriental Income), and those that invest principally for growth but have a high distribution policy where payouts may be funded out of capital (JPMorgan Asia Growth & Income, Invesco Asia Trust [IAT]). IAT is a recent addition to the peer group after it adopted a 4% annual distribution policy in August 2020.

HFEL has always had the strongest focus on higher-yielding companies, which has caused it to lag in performance terms since the onset of the pandemic given the very strong returns generated by lower-yielding technology stocks in Asia. This has also fed through into the longer-term numbers, and the trust currently ranks fifth in the peer group for NAV total returns over one, three, five and 10 years (compared with second over one and three years [at the start of 2020](#)). As shown at the beginning of this note, the majority of HFEL's returns to shareholders over time have come from dividends, which have always been fully covered by income, and we would argue the current 7.2% dividend yield (by far the highest in the sector and almost double the average of the four peers) is evidence of its continued attraction to investors seeking a consistently high income, borne out by the fact that it trades at the highest premium to NAV of 2.7%.

Unusually for HFEL, the trust has the second highest level of net gearing (albeit a notable reduction on the 7% gearing at end-May 2021). Ongoing charges are above average; however, there is no performance fee.

Exhibit 8: AIC Asia Pacific Equity Income sector at 21 July 2021*

% 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	483.7	5.1	7.6	29.5	85.4	1.08	No	2.7	104	7.2
Aberdeen Asian Income	404.0	25.9	28.7	51.4	122.9	1.04	No	(10.1)	107	3.9
Invesco Asia Trust	240.7	27.8	39.9	86.3	174.2	0.99	No	(10.0)	100	4.2
JPMorgan Asia Growth & Income	474.4	21.2	40.1	101.1	136.5	0.74	No	1.7	100	3.9
Schroder Oriental Income	724.0	22.3	27.3	55.0	162.1	0.87	Yes	(4.5)	104	3.8
Sector average (5 funds)	465.3	20.5	28.7	64.7	136.2	0.94		(4.0)	103	4.6
HFEL rank in peer group	2	5	5	5	5	1		1	2	1

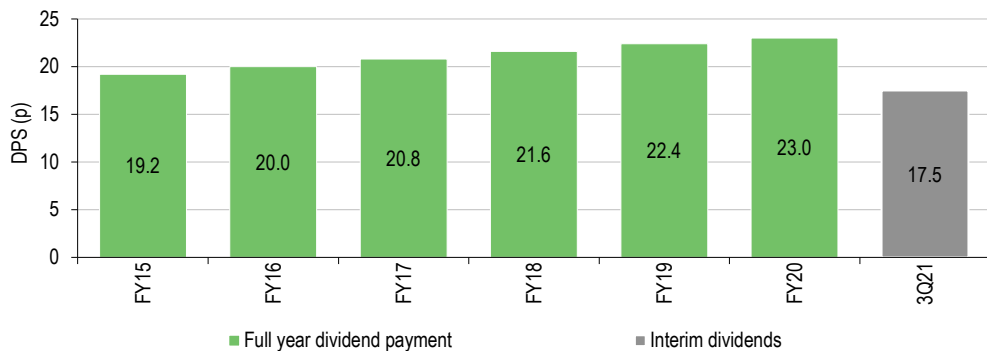
Source: Morningstar, Edison Investment Research. Note: *Performance at 20 July 2021 based on cum-fair NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

Dividends: High, rising and covered by income

Since its launch in 2006, HFEL has paid quarterly dividends in February, May, August and November. Total dividends have increased every year, growing at a compound annual rate of 3.7% over the five years to end-FY20 and to date have always been fully covered by income, including in FY20 when COVID-19 provisions hit payouts in many areas around the world. The third interim dividend of 5.9p announced in June 2021 was a 1.7% increase on the previous two quarters. Although many of the dividends HFEL received during FY20 were based on FY19 (pre-pandemic) earnings, Kerley says income for the first half of FY21 was also ahead of the comparable period in

FY20, despite a 9% decline in aggregate dividends for the Asia Pacific region in calendar 2020. The trust's dividend receipts are heavily weighted to the second half of its financial year, but the manager says many payments so far in H221 have been ahead of analyst expectations. Option premium income in H121 was also slightly ahead of H120, making up 11.4% of total income compared with 10.7% a year earlier. The consistent record of a fully covered and growing dividend is all the more impressive given significant growth in the share base (19.4m shares issued since the start of FY20). The trust's revenue reserve stood at £17.4m at end-H121, equivalent to 0.55x the annual dividend. Based on the current share price and the last four quarterly dividends (amounting to 23.3p), HFEL has a dividend yield of 7.2%, which continues to look highly attractive compared with most other investments.

Exhibit 9: Dividend history since FY15

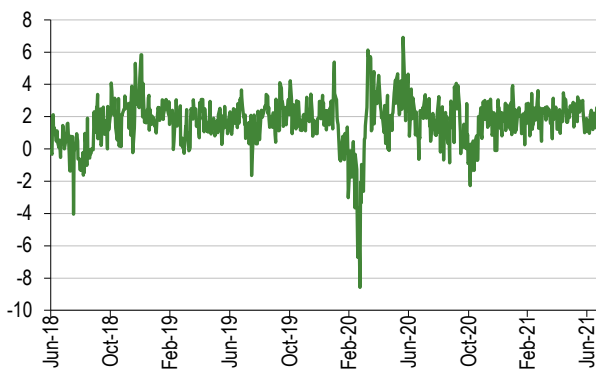


Source: Henderson Far East Income, Edison Investment Research

Discount: Back to trading at a consistent premium

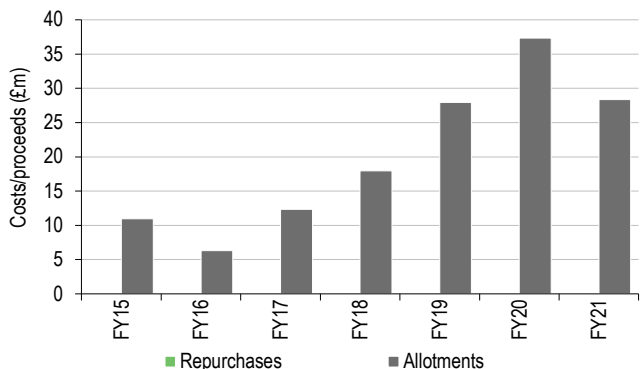
At 22 July 2021, HFEL's shares traded at a 2.7% premium to cum-income NAV. This is higher than the medium-term averages of 1.8%, 1.7% and 1.4% respectively over one, three and five years and well ahead of the 10-year average premium to NAV of 0.9%. Having gapped out to an 8.6% discount (the widest in three years) in March 2020 during the coronavirus-driven global equity market sell-off, the rating swiftly rebounded, reaching a 10-year highest premium of 6.9% in June 2020 before settling back into a more normal range between par and a c 4% premium. The board regularly issues new shares to meet excess demand, with 8.7m shares allotted in the past 12 months. As can be seen in Exhibit 11, issuance in the first 11 months of FY21 has already exceeded the total for every year shown with the exception of FY20. This suggests investors continue to be attracted by HFEL's combination of high yield and relatively low volatility.

Exhibit 10: Premium/discount over three years



Source: Refinitiv, Edison Investment Research

Exhibit 11: Buybacks and issuance



Source: Morningstar, Edison Investment Research

Fund profile: Benefiting from growing dividend culture

HFEL was designed to capture the change in dividend culture in Asia versus the rest of the world, which has gathered pace since the trust's launch in 2006 as a Jersey-incorporated successor vehicle to the onshore Henderson Far East Income trust. Fund managers Mike Kerley and Sat Duhra aim to achieve a high and growing income, as well as capital growth, by investing across the Asia-Pacific region (including India and Australasia). HFEL has no restrictions on country and sector weightings and may invest in Japan, although in practice this is likely to be only to a limited extent. 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. As well as equities, HFEL may hold warrants, debt securities and equity-related securities, such as pre-IPO stocks that are expected to list shortly. The managers may write put or call options to generate additional income (an average of 10 options are written per year) and the trust is permitted to gear up to 30% of gross assets (net gearing of 4% at end-June 2021).

The trust's shares are listed on the London and New Zealand stock exchanges and it is a member of the Association of Investment Companies' Asia Pacific Equity Income sector. While it has no official benchmark, HFEL measures its performance with reference to a broad Asia Pacific ex-Japan index and the MSCI AC Asia Pacific ex-Japan High Dividend Yield Index.

Investment process: Income at a reasonable price

HFEL uses a consistent and disciplined approach to build a portfolio of c 40–60 stocks (currently 49) from across the Asia-Pacific region. The managers seek cash-generative companies with good growth prospects, trading at valuations that suggest the market is underestimating the value of their future cash flows, and blend holdings that have a high starting yield with those offering superior dividend growth prospects, aiming to provide an attractive total return.

Kerley, who is based in London, and Duhra, who works out of Janus Henderson's Singapore regional hub along with the analysts who support the team, meet frequently with companies around the Asia-Pacific region and use industry research and quantitative screening to help identify companies with high yields and/or high dividend growth prospects. They seek to understand the business drivers and key risks of potential investee companies, and build proprietary models focusing on cash flow generation, to establish a target price range.

HFEL's portfolio is mainly made up of companies that have a market capitalisation of at least \$1bn, with a bias towards mid-cap (\$3–10bn) stocks and a tendency to be underweight mega-caps, which can be expensive owing to their high profile in indices, and may not pay dividends. The team generally does not buy non-yielding companies (where the absence of a dividend policy can make forecasting difficult), although some holdings may have relatively low yields of 1–2%.

Exhibit 12: HFEL portfolio metrics versus indices at 30 June 2021

Metric	HFEL	Broad Asia Pacific ex-Japan index	MSCI AC Asia Pacific ex-Japan HDY Index
Price/book (x)	1.3	2.0	1.4
P/E 12m forward (x)	9.4	17.1	9.4
Dividend yield (%)	4.8	2.4	5.1
Dividend yield est 12m forward (%)	5.2	2.7	5.3
Free cash flow yield (%)*	9.2	4.0	8.8
EPS growth est 12m forward (%)	15.7	27.0	11.5
Return on equity (%)	12.2	12.9	14.7
No. of constituents	45	1,850	203

Source: Henderson Far East Income, Edison Investment Research. Note: *Excludes financials sector.

The fund's characteristics versus the broad and high-yield Asia-Pacific equity indices are shown in Exhibit 12. Given its focus on income-generating companies trading at attractive valuations, HFEL's holdings tend to trade on lower average P/E and price/book multiples than the broad index, as well as having higher dividend yields. The high free cash flow yield on the portfolio (at 9.2%, versus 4.0% for the broad index) gives the managers reassurance on the sustainability of dividends, while Kerley says the forecast earnings per share growth of 15.7% is 'impressive' given the portfolio's low average P/E and high dividend yield.

Rather than simply relying on consensus forecasts (on which the index metrics are based), the HFEL team looks for the possibility of dividend surprises. Examples of such surprises since the start of 2021 include Australian telecom operator Telstra (+60% versus expectations), Bank of China (+18%), Taiwan Cement (+40%) and Macquarie Group (+86%).

Portfolio turnover in H121 was c 100% on an annualised basis, which was a little higher than the typical c 70–90% range, although down from c 119% in FY20. 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 approach to ESG

While HFEL has not yet codified its own approach to environmental, social and governance (ESG) investing, the fund is run in accordance with Janus Henderson's corporate ESG principles. To quote from Janus Henderson Investors' literature, 'We believe there is a strong link between sustainability issues and the companies that will grow and succeed going forward. This applies to us as an organisation and to the companies our investment teams actively engage with in their pursuit of long-term returns for our clients.' The firm has a corporate ESG policy group, under which is an ESG advisory group focusing mainly on internal issues, while the ESG investment oversight group ensures principles of sustainability are embedded and adhered to within investment teams.

With regard to HFEL, Kerley and his team do not exclude any sector on ESG grounds with the exception of munitions. The manager says that to reach the trust's long-term ESG goals, 'the transition is just as important as the destination. We want to invest in companies that are improving the environment in which we live, whether they are producing oil or electronics – we want best-of-breed companies where the benefits are there for all.' There is a constant process of engagement with companies to ensure they keep to the ESG targets they set, particularly in environmental terms. Kerley adds that governance 'has always gone hand in hand with an income strategy because dividends are tangible evidence of good corporate governance'.

Many Asian nations are understandably behind the West in terms of tackling environmental degradation, given they have much more recently undergone rapid industrialisation. As such, says Kerley, there are some areas where 'it will get worse before it gets better'. He gives the example of cement, which scores poorly on environmental metrics. 'We invest in the most efficient cement company in China, and we engage with them and hold them to their emissions targets,' the manager explains, arguing this has more impact than excluding the sector and hoping that someone else will hold them accountable.

Gearing

HFEL is permitted to gear up to 30% of gross assets, although in practice its £50m multicurrency bank loan facility is equivalent to only 10% of gross assets. Over the past 12 months net gearing (4% at end-June 2021) has ranged from zero (with a small net cash position in August and September 2020) to 7% at end-May 2021, averaging 2.3% geared. The increase in gearing (which did not exceed 1% between June and October 2020) has broadly coincided with the market rotation

towards more value and cyclical stocks, with average net gearing of 4.3% between November 2020 and June 2021.

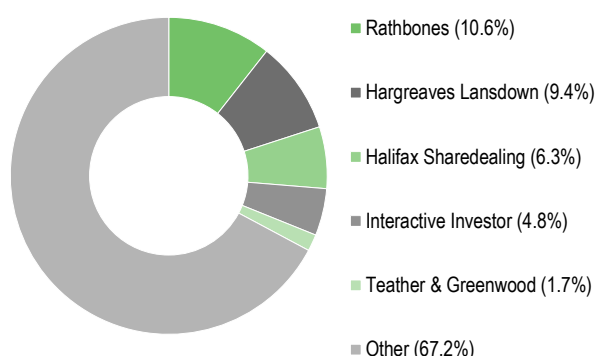
Fees and charges

The trust pays its alternative investment manager (AIFM), Henderson Investment Funds, an annual management fee of 0.90% of net assets up to £400m and 0.75% thereafter, with no performance fee payable. Ongoing charges for FY20 were 1.08%, a 3bp reduction from 1.11% in FY19 despite net assets falling by 9.2% over the year.

Capital structure

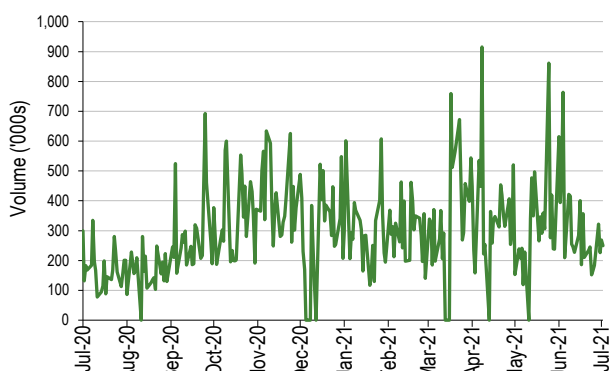
HFEL was set up as a London-listed but Jersey-based closed-end investment company in 2006, and while it retains its Jersey corporate structure, during FY19 it moved its tax residence to the UK and joined the investment trust regime. It has one class of share, with 150.2m shares in issue at 22 July 2021, an increase of 8.7m over the preceding 12 months (see Exhibit 11). Average daily traded volume in HFEL's shares (Exhibit 14) was 310,400 over the 12 months to 22 July 2021, which represents a reasonable level of trading liquidity at approximately 0.2% of the share base per day. As shown in Exhibit 13, three large retail investor platforms (Hargreaves Lansdown, Halifax Sharedealing and Interactive Investor) account for c 20% of the shares in issue, with a further c 10% held by wealth manager Rathbones.

Exhibit 13: Major shareholders



Source: Bloomberg, at 1 July 2020.

Exhibit 14: Average daily volume



Source: Refinitiv. Note: 12 months to 22 July 2021.

The board

Exhibit 15: Henderson Far East Income's board of directors

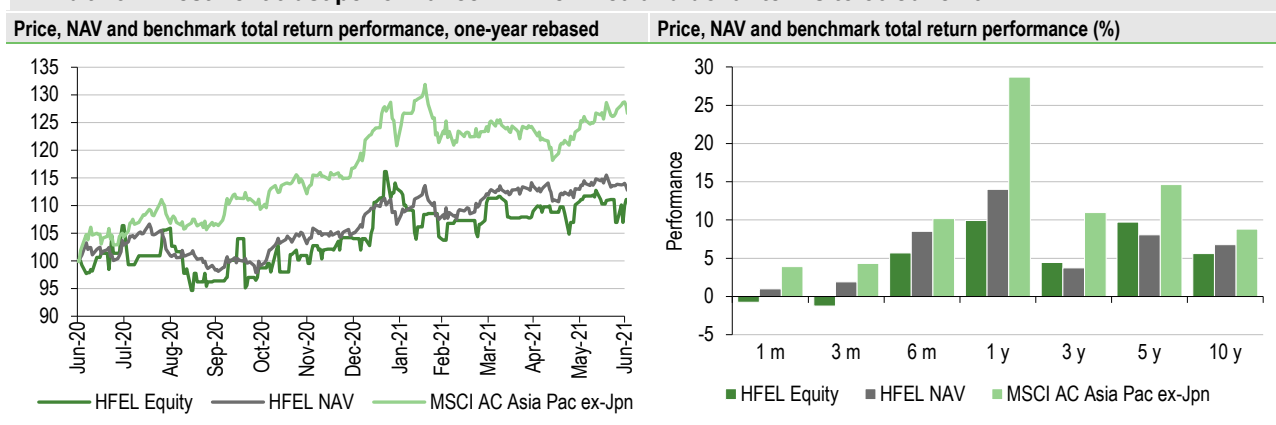
Board member	Date of appointment	Remuneration in FY20	Shareholdings at end-FY20
John Russell (chair)	2006	£39,238	70,306 (+10k in FY20)
Nicholas George (audit cttee chair)	2016	£34,000	8,750
David Mashiter	2006	£31,500	5,000
Julia Chapman	2015	£31,500	2,616
Tim Clissold	2018	£28,968	15,000

Source: Henderson Far East Income, Edison Investment Research

Having previously indicated that David Mashiter would retire in 2020 and John Russell would step down in 2021, HFEL's board has put succession plans on hold as a result of the COVID-19 pandemic, preferring to keep its two most experienced directors in place to help navigate the period of uncertainty. An update on the timing of succession planning is pending.

Performance tables in New Zealand dollar terms

Exhibit 16: Investment trust performance – in New Zealand dollar terms to 30 June 2021



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

HFEL's main listing is on the London Stock Exchange, but its shares are also listed on the New Zealand Stock Exchange so that shareholders there can trade more easily and receive dividends in New Zealand dollars. In Exhibits 16 and 17 we present the trust's performance and that of the MSCI AC Asia Pacific ex-Japan index in NZ dollar terms. A stronger sterling on the back of post-Brexit trade deals has meant higher returns for NZ dollar investors over six and 12 months to 30 June 2021, although both short-term (one and three months) and longer-run returns are broadly similar in both currencies (see Exhibit 6).

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

12 months ending	Share price (%)	NAV (%)	MSCI AC Asia Pac ex-Japan (%)	MSCI AC Asia Pac ex-Japan HDY (%)	CBOE UK All Companies (%)
30/06/17	24.6	16.8	21.8	18.1	11.8
30/06/18	12.0	13.0	18.8	14.6	20.4
30/06/19	11.1	5.6	1.9	6.3	(2.6)
30/06/20	(6.6)	(7.3)	4.3	(7.5)	(12.5)
30/06/21	9.9	14.0	28.7	17.9	24.7

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

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Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia