

Henderson International Income Trust

Diversify your income

The sharp falls in sterling over the past few months have flattered the performance of many funds investing overseas, including Henderson International Income Trust (HINT), but have compounded problems for some UK equity income trusts. The threat of dividend cuts looms large for UK-focused trusts and now, more than ever, the yield on HINT's overseas equity portfolio should look very attractive to UK-based investors. HINT has just raised its quarterly dividend to 1.2p, up 4.3% on the previous quarterly dividend.

Five years after HINT's launch, the arguments in favour of the fund are as strong as ever. Threats to dividends in the oil, mining and financial sectors run the risk of severely denting the amount of income available to investors in the UK market. What compounds the problem is that the UK market is unnaturally skewed towards these sectors. Investing internationally reduces risk and opens up new opportunities.

Overseas equity income for UK investors

HINT aims to provide a high and rising level of dividends as well as capital appreciation over the long term, from a focused and internationally diversified portfolio of securities outside the UK.

Year ended	Share price total return (%)	NAV total return (%)	MSCI World ex UK total return (%)	MSCI World total return (%)	MSCI UK total return (%)
30/09/12	20.8	20.2	17.4	17.3	16.4
30/09/13	13.7	17.3	20.2	19.9	16.7
30/09/14	(0.1)	7.5	12.7	12.1	6.0
30/09/15	8.5	2.5	2.3	1.6	(5.9)
30/09/16	28.4	29.4	30.8	29.9	18.4

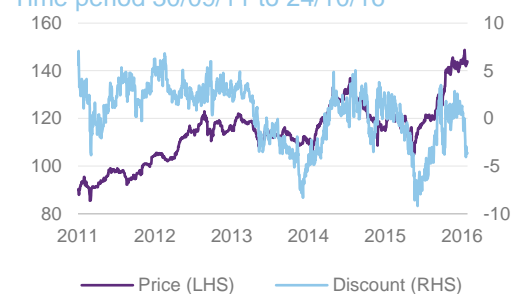
Source: Morningstar, Marten & Co

Sector	Global equity income
Ticker	HINT LN
Base currency	GBP
Price	144p
NAV	149.43p
Premium/(discount)	(3.6)%
Yield	3.2%*

Note: * historic, 3.3% on new forecast

Share price and discount

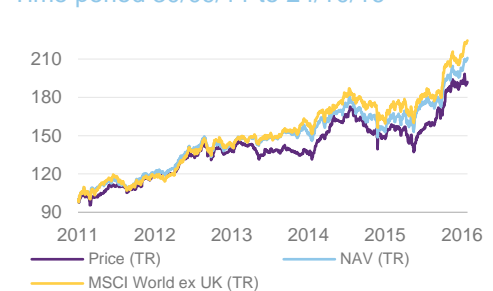
Time period 30/09/11 to 24/10/16



Source: Morningstar, Marten & Co

Performance over five years

Time period 30/09/11 to 24/10/16



Source: Morningstar, Marten & Co

Domicile	UK
Inception date	28 April 2011
Manager	Ben Lofthouse
Market cap (GBP)	225.4m
Shares outstanding	156.6m
Daily vol. (1-yr. avg.)	195,095 shares
Net gearing	0.0%

[Click here for our initiation note](#)

HINT's market cap is almost 25% larger than it was in May 2016

Sterling weakness is benefitting HINT's revenue account, the quarterly dividend has been increased by 4.3%

HINT provides an ideal and unique way to diversify your source of dividend income outside the UK

You can access the company's website at: www.hendersoninternationalincometrust.com

It seems remarkable how much HINT has grown over the few months since we published our initiation note. That note was produced shortly after a significant proportion of the shareholders in Henderson Global Trust had rolled over their investment in that fund to an investment in HINT. On 4 May 2016, HINT was trading at a discount of 4.2% and had a market cap of £185.8m. Since then, the discount has narrowed (HINT has traded at a premium for more than half the time since our note was published), 1.1m shares have been issued and the NAV has risen by 19.8%. The combination of these factors means that HINT now has a market cap of £225.4m, making it almost a quarter larger than it was at the start of May 2016.

Of course, since HINT's portfolio is exclusively comprised of stocks traded outside the UK, part of the rise in the NAV can be attributed to the dramatic fall in the value of the pound since the UK's referendum on EU membership. This also has a beneficial effect on HINT's revenue account. HINT's board has decided to raise the quarterly dividend to 1.2p, a 4.3% increase on the previous quarterly rate of 1.15p. In this update, we include the manager's thoughts on the state of markets, the major changes to the portfolio since we last published and the trust's recent performance.

Fund profile

HINT launched at the end of April 2011. At the time, many UK equity income funds were struggling to maintain their dividends, as a number of large dividend payers in the UK index had cut or passed their dividends in the wake of the global financial crisis and, in BP's case, the Deepwater Horizon drilling rig explosion. It was obvious to many that UK investors holding just UK equity income funds had too much stock and sector-specific risk. Even in 2015, just five stocks accounted for a third of dividends paid in the UK (according to Capita) and, at the end of February 2016, just 20 companies accounted for over 70% of all UK dividends. HINT, which invests globally, excluding the UK, offers a useful and practical way of diversifying investors' sources of dividend income and is the only UK closed-end fund with a global ex UK, income-focused mandate.

HINT's goals are to grow investors' income ahead of inflation and to also grow their capital. HINT pays quarterly dividends and, as the fund was set up in response to the problems created by a swathe of dividend cuts in the UK market, the manager places an emphasis on ensuring that HINT has a secure flow of income. The fund has been managed since launch by Ben Lofthouse (Ben or the manager). He joined Henderson Global Investors (Henderson) in 2004 and has managed global equity income funds there since 2006. In addition to managing HINT, he also co-manages two open-ended funds – Henderson Global Equity Fund and Henderson Horizon Global Equity Fund. There is some crossover in holdings between the funds, but they do not share HINT's global ex UK mandate. Henderson's 12-strong, global equity income desk, headed up by Alex Crooke, has assets under management of about £12bn. Half of this sum is invested in global funds (including funds such as Bankers Investment Trust) and the rest is in regional funds such as City of London and Lowland.

HINT is benchmarked against the MSCI World ex UK Index for performance measurement purposes, but the composition of the Index does not influence stock selection decisions.

Manager's view

Much of the income from the UK market is concentrated in a handful of stocks

Ben believes that the fundamental arguments in favour of HINT's global ex UK mandate are as strong today as they were when the fund was launched just over five years ago. The majority of the dividend income generated by the UK market comes from a handful of stocks in a narrow range of sectors. There is a real need, for any investor relying on the income from their investments, to diversify their income stream by including overseas stocks in their portfolio. HINT offers a simple, one-stop, way of achieving that.

Manager is focused on reducing dividend risk

Over the past few months, Ben's focus has been on minimising the dividend risk in the portfolio, emphasising stocks that can grow their dividends and have relatively stable revenues. Companies are being tested; capital is cheap, there is a lot of disruptive activity; and exchange rates are fluctuating wildly.

The sectors suffering the most are the ones that feature highly in the UK index

Falling commodity prices have hit the profitability of many oil and mining stocks and the companies that supply to them. In part because of the low interest-rate environment, some financials stocks are struggling too. These three sectors account for most of the current pressure on dividends. Coincidentally, these are also sectors that are heavily represented in the UK index and they account for a large proportion of dividend income in the UK. This underscores the argument for diversifying your revenue stream by looking overseas for income.

Brexit is importing inflation, putting pressure on some UK companies

The UK economy is also being tested by the collapse of sterling post Brexit. The full effects of this have not yet materialised, but the pressure on retailers and importers of goods for resale in the UK was illustrated by the recent spat between Unilever and Tesco. Imported inflation and the difficulty of passing that on to financially stretched consumers could be another problem area for UK dividends.

Where, in a more normal economic environment, Ben would be happy to hold a good company throughout an economic cycle, today he thinks it is right to remove those stocks that are struggling and focus on quality. He is being careful, however, not to overpay for income, given the huge demand for it in this low interest-rate environment.

Ben does not feel comfortable trying to predict when low interest rates and highly priced long bond markets might normalise. He is trying to avoid making a bet on this either way. Nor is he overly preoccupied with political upheavals. He notes the rhetoric around the pharmaceutical industry in the US, but thinks that any price controls will most likely be focused on the manufacturers of older patented therapies, in line with where most of the price-fixing scandals have originated.

Maintaining a value bias while avoiding value traps

Ben has been trimming stocks that have done well and is maintaining a value bias within the portfolio. He is avoiding deep value however, given the global economy's anaemic growth.

Asset allocation

Gearing eliminated

When he received the influx of assets from the Henderson Global rollover (as a mixture of cash and shares in companies that Ben wanted for the HINT portfolio), He used the opportunity to eliminate the gearing on the trust. He added a few new holdings to the portfolio at the same time.

Rotating money from US to Europe

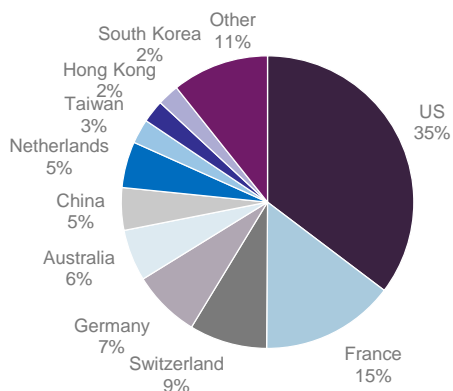
Ben's asset allocation decisions are intrinsically countercyclical. Having previously had an overweight exposure to the US relative to most of the peer group, which was beneficial to HINT's relative performance, Ben has been taking profits in this area and

increasing exposure to mainland Europe. Europe appears to be out of favour with many investors. Funds have been flowing out of the region for most of 2016. However, Ben thinks that the European economy should be benefitting from lower fuel prices, accommodative monetary policy and falling unemployment. He believes that parts of Europe are starting to or will soon emerge from austerity. Concerns about the strength of some European financial institutions, such as Deutsche Bank, have dragged down the valuations of other stocks in the European financials sector and Ben is keen to take advantage of valuation anomalies in this area.

First foray into Japan

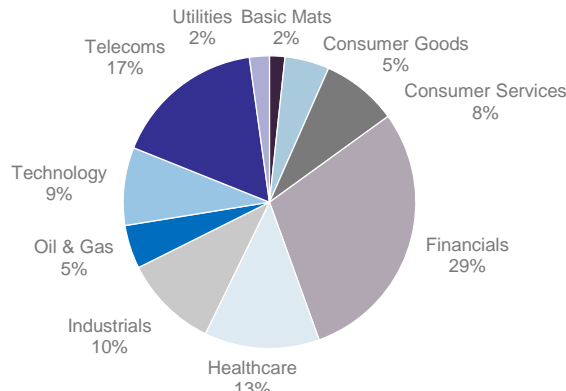
Ben has also been taking an interest in Japan, where yields are rising as corporate governance reforms encourage companies to pay out some of the cash on their balance sheets. It is, maybe, too early to make a significant allocation to the country as very few stocks yield more than 3% as yet, but he sees some examples of more focus on dividend growth and shareholder returns.

Figure 1: Geographic split of the portfolio at 30 September 2016



Source: Henderson International Income, Marten & Co

Figure 2: Industry sector split of the portfolio at 30 September 2016



Source: Henderson International Income, Marten & Co

Looking at Figure 1, Ben has trimmed the US weighting by three percentage points between 31 March 2016 (the data available when we published the initiation note) and 30 September 2016. The Swiss weighting has also fallen, by 4%. The Taiwanese weighting is higher and so is the allocation to Japan (contained within “Other” in the pie chart).

Within the industry sector split, shown in Figure 2, the industrials weighting is about 3% lower than it was at the end of March and there have been increases in consumer goods, utilities, telecoms and healthcare.

The top 10 holdings

Turnover on the portfolio has been a bit higher than usual, chiefly as a result of the Henderson Global rollover and some stocks reaching Ben’s target valuations. The top 10 holdings have altered quite a bit since the end of March with only four stocks, Novartis, Roche, Microsoft and Cisco Systems, still on the list. The largest new entrant is Taiwan Semiconductor and other stocks that are new to the top 10 are two telecoms companies, Orange and Deutsche Telekom; two banks, ING Groep and Natixis; and French property company, ICADE.

Figure 3: 10 largest holdings at 30 September 2016

Stock	% of total assets 30/09/16	% of total assets 31/03/16	% Change	Sector	Business focus	Country
Novartis	3.6	3.2	0.4	Healthcare	Pharmaceuticals	Switzerland
Roche	3.4	2.8	0.6	Healthcare	Pharmaceuticals	Switzerland
Microsoft	3.4	3.1	0.3	Technology	Software	US
Taiwan Semiconductor	2.7			Technology	Semiconductors	Taiwan
Orange	2.6			Telecoms	Telecoms	France
Cisco Systems	2.5	2.2	0.3	Technology	Software	US
Deutsche Telekom	2.5			Telecoms	Telecoms	Germany
Natixis	2.5			Financials	Banks	France
ING Groep	2.4			Financials	Banks	Netherlands
ICADE	2.3			Financials	Property	France
Total	25.7					

Source: Henderson International Income, Marten & Co

New entrants to the top 10

Ben says that Taiwan Semiconductor funds an R&D programme from its strong cash flow that keeps it ahead of its competitors. It trades on an historic p/e of 16.3x and a dividend yield of 3.1%, having been increasing its dividend ahead of analysts' expectations.

In September, Orange was a new entry to the list of the top 10 holdings. We mentioned Ben's attraction to telecoms companies in our initiation note of 4 May 2016. To summarise, it is a good example of a sector where HINT is able to achieve much greater geographic diversification and exposure to different regulatory environments than would be available to a UK equity income fund whose choice of stocks is much more limited.

Other new holdings in the portfolio include ING Groep (ING), Natixis and Panasonic. ING is famous in the UK for running into trouble during the financial crisis with its ING Direct savings product. Ben says that, having put its problems behind it, ING is now in possession of a number of challenger bank businesses in Germany, Austria, Spain, Italy, France and Australia which could be a growth engine for the company. Ben favours Natixis because he feels that it is focused on maximising its returns rather than growing its risk-weighted assets. It has a large US-based asset management business in addition to its French bank. Both banks are trading at a discount to book value.

Japanese electronics company, Panasonic, which trades on an historic p/e of 16.1x, has a yield of 2.3% that is covered 3.3x by earnings and it is increasing its dividend. In addition to its traditional business, Panasonic is making the batteries that power Tesla's cars.

Exiting the top 10

Companies no longer included within the top ten are Verizon, Six Flags Entertainment, Lockheed Martin, Nielsen, Eurocommercial Properties and Chevron. Ben has trimmed the trust's holding of Six Flags Entertainment on valuation grounds after it rose fivefold in as many years. Ben believes that the growth of "min vol" funds in the US has pushed the prices of some stocks beyond levels that Ben is comfortable with. Lockheed was one stock he sold on those grounds and he also trimmed the trust's position in General Electric. He has also reduced the trust's holdings in tobacco company, Reynolds

American, Swiss financial services company, Cembra Money Bank and Rexel, which we discuss in greater detail below.

Ben says that the portfolio valued on an average forecast p/e of around 15x as compared with 17.2x for the comparative index. The dividend yield on the portfolio exceeds 4% and the portfolio beta is lower than it was at around 0.9x.

Performance

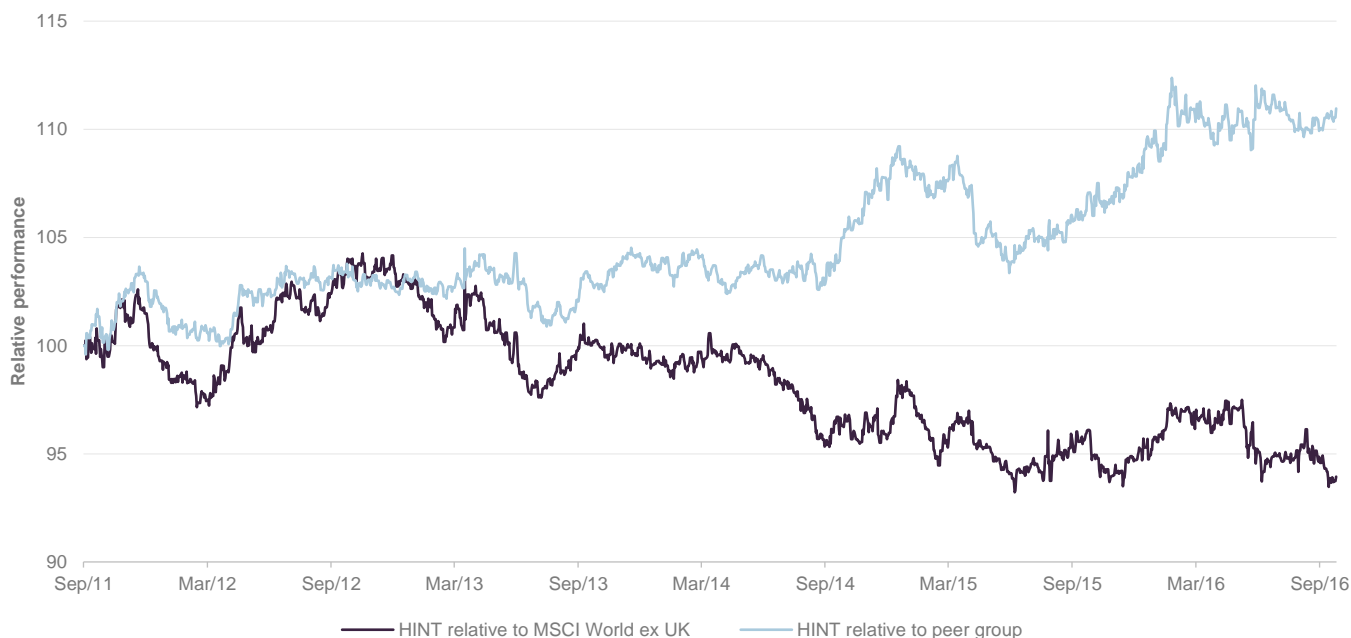
Recently stock selection has been positive, but overweight to Europe held back relative performance

HINT's recent performance has been aided by good stock selection, but some relative gains were lost as a result of the trust's overweight exposure to Europe. Positive contributions to performance were made by holdings in Six Flags Entertainment, Reynolds American, Nexity and Cembra Money Bank. Nexity is a French housebuilder whose shares have tripled over the past five years.

On the downside, French electrical supplies distribution business, Rexel, has been adversely affected by the general economic malaise. A boardroom row precipitated a sharp drop in its share price. Ben had become concerned about the company's ability to maintain its dividend and sold the shares after they had bounced.

Figure 4 shows HINT's strong outperformance of its peer group over the past five years. HINT's performance relative to the comparative index has been fairly flat over the last couple of years.

Figure 4: HINT total return performance relative to both benchmark and peer group over five years



Source: Morningstar, Marten & Co

Figure 5 shows how HINT compares to its AIC peer group. The peer group has expanded recently with the addition of JPMorgan Global Growth & Income (formerly JPMorgan Overseas). The JPMorgan fund is quite different from HINT however. It is managed without any yield objective in mind – instead it pays a fixed rate of dividend, making up any shortfall in revenue from its capital reserves (which is likely to eat into its capital performance). On the grounds that the AIC has agreed to include it within HINT's peer group and there has been no change in the way that fund's portfolio is

managed, we have included the performance of that fund within the peer group averages for all time periods.

Figure 5: Fund of fund subsector comparison table (data as at 24/10/16)

	Market cap GBPm	Discount (%)	Yield (%)	Ongoing charge (%)	NAV total return performance to 24/10/16		
					1 year (%)	3 years (%)	5 years (%)
Henderson International Income	225	(3.6)	3.2	1.12	29.1	42.6	98.1
Peer group average	331	(4.2)	3.7	0.96	24.0	31.9	79.2
F&C Managed Portfolio Income	52	(1.0)	4.3	1.07	11.0	18.2	67.1
Invesco Perp Select Global Eq.	59	(1.7)	3.3	0.96	22.7	40.3	97.4
JPMorgan Global Inc & Growth	325	(9.3)	2.5	0.64	27.8	50.1	104.4
London & St Lawrence	102	(8.1)	4.2	0.73	8.3	19.9	65.4
Murray International	1,452	(5.0)	4.1	0.75	47.5	32.8	74.1
Scottish American	416	(0.8)	3.5	0.93	33.7	42.2	83.6
Securities Trust of Scotland	177	(7.4)	3.7	0.97	27.6	28.8	78.3
Seneca Global Income & Growth	63	(0.1)	3.8	1.60	12.9	22.9	62.9

Source: Morningstar, Marten & Co

You can find an up-to-date comparison of HINT with its peer group on [our website](#)

HINT is now the fourth largest fund in its peer group. Its discount is a little narrower than the peer group average. Its yield is towards the lower end but, as we explained in our initiation note, this might reflect HINT's focus on security of income and dividend growth over investing in the highest yielding stocks. HINT's ongoing charges ratio should fall next year now that the fund has grown, as fixed expenses are spread over a wider cost base. This should also help to boost its yield.

Previous research publications

Readers interested in further information about HINT may wish to read our initiation note *Yield, performance and liquidity*, published on 4 May 2016. The contents pages have been reproduced below. You can read the notes by clicking on the menu below or by visiting our website.

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