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In dividends we trust: analysts highlight investment company options

With dozens of companies cutting or suspending dividends and interest rates remaining near all-time lows, income hunters should not ignore the unique attractions of investment trusts.

Investment companies have the ability to reserve up to 15% of their income each year, which has helped them to carry on raising dividends through such intense market downturns as the 1987 crash, the dot com bubble bursting and the financial crisis.

Companies in the UK equity income, global and global equity income sectors are particularly well known for this, and dominate the **AIC's list of 'dividend heroes'**.

However, these are not the only sectors generating healthy yields and reliable income streams, The Association of Investment Companies found from investment company analysts as they shared which other investment company sectors they consider for income.

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Anthony Stern, analyst at Stifel, said: "We think the Asia Pacific Income funds offer a different source of income. Asia was the region first into the COVID-19 crisis and the first out. The Asian funds offer dividend yields of 5% or more and these dividends are fully covered by revenue income, unlike some trusts in the investment company world. The funds have been recognised for increasing their dividends over the long term and are part of the AIC's next generation of dividend heroes. All of the funds have substantial revenue reserves which should allow them to maintain their dividends through their lean times.

"Aberdeen Asian Income (LON:AAIF) is clearly the value play in the sector at a 13% discount and offering a 5.5% dividend yield. Schroder Oriental Income (LON:SOI) has been managed since inception by the highly experienced Matthew Dobbs. It has one of the best track records of the Asia Pacific Income funds on a total return basis and offers a dividend yield of 5.3%."

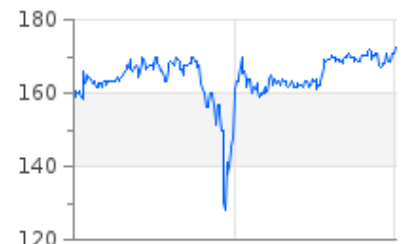
Anthony Leatham, head of investment trust research at Peel Hunt, said: "Outside of UK and Global Equity Income, there are a number of sectors and regions that offer attractive yields. We would highlight the differentiated equity income story in Japan. Richard Aston has been manager of CC Japan Income & Growth Trust (LON:CCJI) since its launch in December 2015, boosted by the focus on shareholder return from Abenomics. CCJI currently offers a yield of 3.8% and an unconventional sector mix versus other developed market equity income strategies.

"Healthcare has historically been a valuable source of equity income for investors. However, this can be at the expense of capital growth. BB Healthcare Trust (LON:BBH) pays its dividend out of capital and currently offers a yield of 3.0%. The benefit of this approach is that it allows the managers to adopt an unconstrained and high conviction approach, without being tied to the high-yielding, often ex-growth stocks in their universe."

Price: 172.2

Market Cap: £1.09 billion

1 Year Share Price Graph



October 2019 March 2020 September 2020

Share Information

Code: BBGI

Listing: LSE

52 week High Low
172.8 125.5

Sector: Financial Services

Website: www.bb-gi.com

Company Synopsis:

We are a global infrastructure investment company helping to provide the responsible capital required to build and maintain the developed world's transport and social infrastructure.

action@proactiveinvestors.com

Income from infrastructure and social housing

Alan Brierley, director of investment companies research at Investec, said: "Sustainability of income is key and our preferred sector is Infrastructure. Our recommendations include HICL Infrastructure (LON:HICL), The Renewables Infrastructure Group (LON:TRIG), Greencoat UK Wind (LON:UKW) and Sequoia Economic Infrastructure Income (LON:SEQI). These companies give a diversified exposure to social, economic and renewable infrastructure along with infrastructure debt.

"Within the debt sub-sector, many constituents had over-promised and under-delivered even in a benign credit environment before the onset of the pandemic. Here, stock selection is even more critical - our preferred investments are GCP Asset Backed Income, which invests in asset-backed loans, and BioPharma Credit which provides debt capital to the life science industry."

Monica Tepes, head of investment companies research at finnCap, said: "If you are looking for as much certainty as possible that your dividends are not going to be cut, I think you need to look at sectors where either the local or state government is your counterparty, or your payments come from businesses which are unaffected or even benefit from the current environment.

"In the first category I can only put infrastructure equity: BBGI (LON:BBGI), International Public Partnerships (LON:INPP), HICL Infrastructure: infrastructure debt, GCP Infrastructure Investments (LON:GCP), Sequoia Economic Infrastructure Income; and supported living, Civitas Social Housing (LON:CSH), Triple Point Social Housing (LON:SOHO).

"In the second category I think there are no clear winning sectors - certain players in the logistics sectors seem to be in the right assets, but others aren't. If the products transiting through your logistics centres are not selling, you will have trouble collecting rents."

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Conor Finn, investment fund analyst at Liberum, said: "Aside from Infrastructure and Renewable Energy Infrastructure funds, we believe the social housing REITs offer the prospect of long-term, uninterrupted income.

"Following recent acquisitions, Civitas Social Housing has achieved full dividend cover on a forward-looking basis and we expect an increase to cover of 1.08 years by Q1 2022. The portfolio produces a long-term, inflation-linked income stream from specialist supported housing. Civitas is focused on accommodation for individuals with care needs that are moderate to high. Rental payments from housing associations are funded from housing benefit. Rent collection in the sector has been unaffected by the COVID-19 crisis, unlike other real estate."

Ewan Lovett-Turner, director of investment companies research at Numis Securities, said: "The investment companies I have highlighted generate their income from a range of asset classes with different underlying return drivers. In addition, they have diversified portfolios with a large number of underlying investments.

"For example, International Public Partnerships has over 100 projects in the UK, Europe, North American and Australia, including public private partnership projects such as schools, courts and police stations as well as offshore transmission cables, transport assets and the Thames Tideway Tunnel project. TwentyFour Income (LON:TFIF) offers exposure to both mortgage and corporate loans across Europe, backed by thousands of underlying loans."

Potential for risks

Simon Elliott, head of investment research at Winterflood Securities, said: "With any investment trust investing in equities overseas for income, there is always the potential for adverse currency movements. These can be meaningful and counter any increase in the level of the underlying dividend, however, this obviously works both ways. Sterling has proven relatively weak in general so far this year, which provides a following wind for overseas equity income mandates."

Liberum's Finn said: "The regulator has been critical of the social housing sector and has highlighted issues at a number of housing associations. The counterparties to the leases are typically smaller housing associations.

"Civitas Social Housing has been working with the housing associations to address the issues raised. Civitas has led several initiatives to improve professionalism and the long-term sustainability of the sector. These include force majeure clauses in the leases, assisting housing associations with governance changes and board appointments and supporting the establishment of a not-for-profit, community interest company. On a portfolio level, Civitas has also been working on increasing the amount of the portfolio that is supported by 25-year, back-to-back care provider leases which represent 30% of the portfolio."

Lovett-Turner at Numis added: "The risks vary widely according to the nature of the underlying assets.

"International Public Partnerships has modest exposure to regulated assets, some of which are subject to periodic price controls where the regulator sets the allowed return. A small part of the portfolio has some demand risk, although there are various downside mitigations within certain contracts which provide some comfort. However, the majority of revenues have a high level of predictability under availability-based payment structures, or through senior debt investments.

"TwentyFour Income could be exposed if default levels in European loans or mortgages are significantly higher than expectations, although there is typically first-loss protection and current valuations are pricing in an increase in defaults."

READ: Really bad news on dividends is yet to come, says Terry Smith

On the outlook, Peel Hunt's Leatham says: "There has and will continue to be dividend disruption facing the market as a result of COVID-19 and its economic impact. Revenue reserves have helped investment companies to deliver income to shareholders through periods of stress and we expect to see this play out again. Volatility may also give certain investment companies more opportunity to use option strategies to enhance the income generated by their portfolios.

"In addition, investment companies can employ gearing to take advantage of market dislocations, boosting the yield. Finally, the closed-ended structure protects portfolio managers from becoming forced sellers. Open-ended fund managers have had to deal with redemption requests and this can have a detrimental impact on portfolio performance and income generation."

Tepes at finnCap adds: "The scarcity of income is nothing new and the economic backdrop of ultra-loose monetary policy is going to make income-producing alternative assets even more attractive. The investment company alternative income sector has grown tremendously over the last 15 years precisely because it can fill this gap, which open-ended funds, equities and bonds can't. I think there will be more income solutions to come from this space."

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