EDISON

Henderson Far East Income

Cautious of continued volatility but value on offer

Investment trusts
Asia Pacific Equity Income

23 November 2022

Price		**264.0p**
Market cap		**£412m**
Total assets		**£396.3m**
NAV*		253.9p
Premium to NAV		4%
*Including income. As at 22 November 2022.		
Yield		9%
Shares in issue		156.1m
Code/ISIN		HFEL/JE00B1GXH751
Primary exchange		LSE
AIC sector		Asia Pacific Equity Income
Financial year-end		31 August
52-week high/low	304.0p	242.0p
NAV* high/low	307.7p	237.7p
*Including income		
Net gearing*		2%
*As at 22 November 2022.		

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. It has stock market listings in London and New Zealand.

Bull points

- High yield covered by earnings in FY22.
- Experienced management duo.
- Relatively low correlation to Asian equities.

Bear points

- Less stylistically balanced than some peers.
- Growth in dividends may lag peers.
- Fees are towards the upper range of peers.

Analyst

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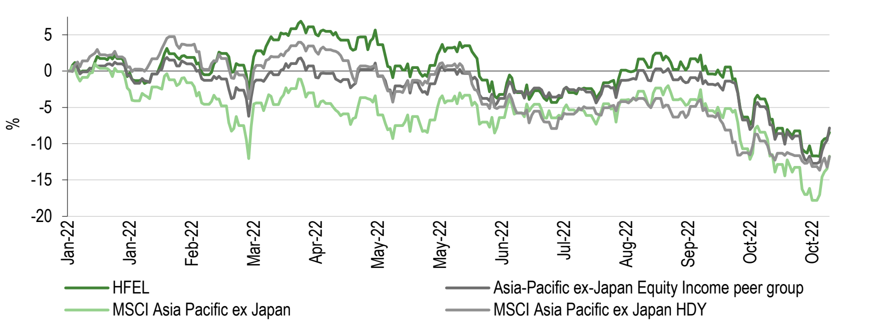
In our last review of Henderson Far East Income (HFEL) in July, Attractive yield despite modest dividend increase, we drew attention to the dividend increase from what is comfortably the highest yielding fund in the AIC Asia Pacific Equity Income sector. It was pleasing to see that in the company's published full year results to the end of August, the dividends paid by the company were covered and that over £1m was added to the revenue reserves over this period. In this note we examine the drivers of performance, although it must be acknowledged that the weakness of sterling has been a tailwind for the portfolio's capital and income returns.

HFEL: A respectable relative performance in the year to date



Source: Refinitiv, Edison Investment Research. Note: Total returns in sterling.

Why invest in Asian income?

Asian markets have had mixed performances in 2022 although increasing inflation has not caused the level of policy response as seen in parts of the West and economic growth has been resilient. However, all is not rosy as China is still some way off relaxing its zero COVID-19 policy, which has a dampening effect on regional and global growth. Recessionary pressures in the West will have an impact on exports and inflation could yet cause slower regional growth. On the positive side, there is little evident pressure on Asian dividends, valuations reflect earnings downgrades and the structural support for regional growth, such as supportive demographics and lack of indebtedness, remain.

The analyst's view

Overall, the managers are cognisant of the risks and are very modestly geared, but the portfolio trades on around 8x forward price to earnings and, with the market trading on c 1.1x book value, historically this has been at or near the bottom of the trading range for Asian equities over the past 30 years. The focus remains on identifying the highest quality, best value companies that can benefit from the secular growth in the region, driven by factors such as a growing affluent middle class and the transition to clean energy. Overall, the investment approach provides a high income and differentiated returns profile that would add diversification to other Asian funds or for those seeking income.

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

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Fund profile: Above-average income

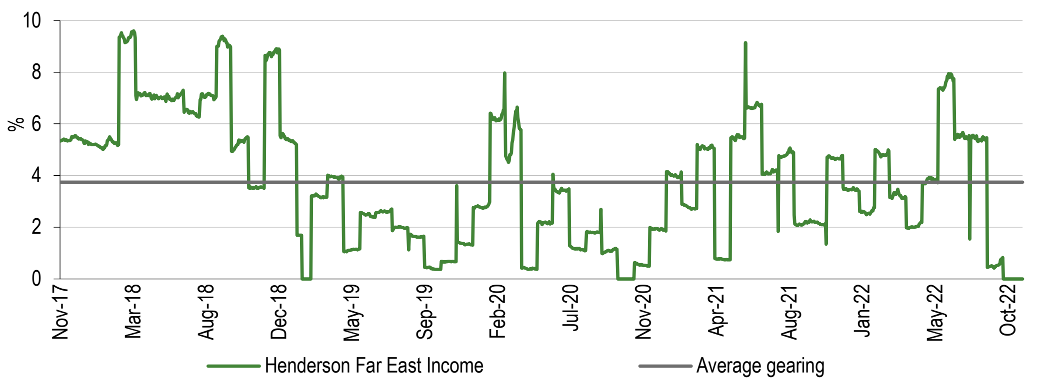
HFEL was designed to capture the change in dividend culture in Asia versus the rest of the world, which has gathered pace since the trust's launch in 2006 as a Jersey-incorporated successor vehicle to the onshore Henderson Far East Income trust. Fund managers Mike Kerley and Sat Duhra aim to achieve a high and growing income, as well as capital growth, by investing across the Asia-Pacific region (including India and Australasia). Dividends are paid quarterly in February, May, August and November. HFEL has no restrictions on country and sector weightings and may invest in Japan, although this is likely to be limited in practice. 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 dependent on the pricing and attractiveness of the opportunity, and have on average written around 10 options per year since inception in 2006. The trust is permitted to gear up to 30% of gross assets; however, historically, gearing has not exceeded 10%.

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

Reasons to be cautious

The IMF is forecasting that global GDP growth will slow from 3.2% to 2.7% in 2023. Some countries in Asia are forecast to grow, with China expected to expand from 3.2% in 2022 to 4.4% in 2023, but some countries in the region are expected to slow, with Australian GDP forecast to drop from 3.8% this year to 1.9% next year. The risks to economic growth are numerous and include an escalation of the war in Ukraine, associated supply chain problems, trade friction between China and the United States over US exports of advanced computer chips to China and central bank policy errors. Geopolitical tensions have been simmering between the West and China for many years but could boil over with tensions around Taiwan's independence and the United States' ban on chip exports. This has the potential to derail regional and GDP growth. Overall, the managers are maintaining a cautious stance and the portfolio is only very modestly geared (Exhibit 1).

Exhibit 1: HFEL management cautiousness has seen gearing reduced



Source: Morningstar. Note: Five years to 7 November 2022.

China offers selective value but is volatile

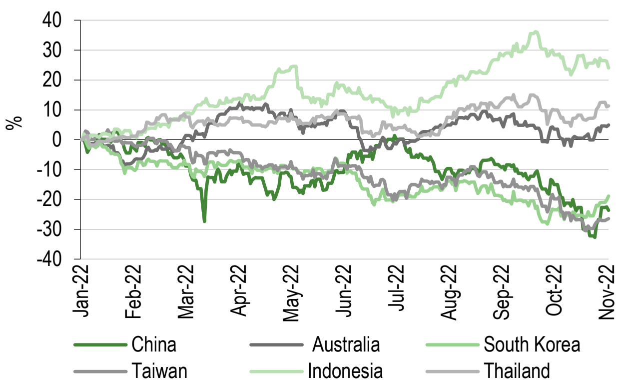
While exposure to China in the fund is underweight (October 2022: 15.4%) to the benchmark MSCI Asia Pacific ex Japan Index (25.9%), what happens in China is important for the region and globally. Kerley does not expect the zero COVID-19 policy to be relaxed before March 2023 at the earliest. This would coincide with the next Communist Party meeting, which will be focused more on economic policy than the 20th National Congress of the Chinese Communist Party held in October this year. By March, winter will have passed, which is the most significant period for the spread of the COVID virus, and there are also several mRNA drugs in Phase III trials that could provide a catalyst for a targeted reopening. Kerley also notes that there is some evidence that inoculation rates in the over 60s, who are the most vulnerable part of the population, have increased. Chinese equities have had a torrid 2022 and for some investors have become almost uninvestable, with the volatility surrounding central policy on certain sectors and the extended periods of draconian lockdowns. There is also the possibility of a property slowdown in China with diminishing asset and credit quality and the delisting of Chinese corporates listed as American depository receipts on the NYSE. These factors have all led to very negative investor sentiment to Chinese equities. Kerley acknowledges these risks and the likely ongoing volatility but feels that valuations have reached extremely depressed levels reflecting these concerns.

Country and sector performance in 2022

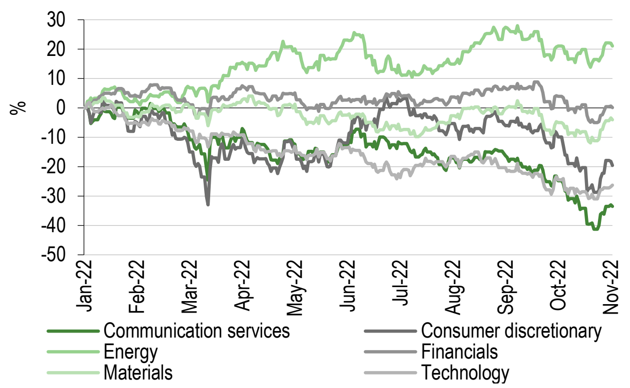
Southern Asian markets such as Indonesia, Singapore and Thailand have been outperforming Northern Asian countries such as Korea and Taiwan through 2022 as they have gained from faster COVID-19 reopenings, generally have less sensitivity to rising energy prices and have benefited from the reversal away from high-growth, interest rate sensitive industries such as technology. Australia and India have also been robust, with Taiwan and China being the weakest at a country level. From a sector perspective, energy has been the standout performer in 2022, with financials also showing resilience. Technology and consumer discretionary have been the weakest. Asian earnings have already been downgraded (unlike in Western markets) and there are likely to be further downgrades ahead, with Kerley's view that the consensus expectations around consumer discretionary and technology earnings are still too high. Despite the better picture in Asia compared with the West in terms of inflation and growth, there is evidence of the consumer trading down as inflationary pressures bite, which will have an impact on corporate earnings and equity market levels.

Exhibit 2: Country and sector performance in 2022 to date

Country performance



Sector performance



Source: Refinitiv, Edison Investment Research. Morningstar. Note: Data to 8 November. Total return in pounds sterling.

Inflation, interest rates and the strong US dollar

The strength of the US dollar has been a headwind for Asian economies and companies as the rising costs of their dollar denominated debt and energy increases the cost of debt and lifts inflation higher, reducing corporate profitability. In addition, a strong US dollar encourages capital flows back to the United States and away from Asia, which affects liquidity, the value of regional currencies and stock prices. Kerley notes that a strong US dollar has historically hurt southern Asian countries more, with northern Asian countries having more defensive, higher-quality earnings and better macro tailwinds (such as lower household debt). This trend reversed in 2022 with southern Asian countries (Singapore, Indonesia and India) outperforming, while the weakest economies and currencies have been in Taiwan, Korea and China. Indonesia, for example, has been a net exporter of commodities, while reopenings after COVID-19 lockdowns have been far quicker in southern Asian countries than in northern Asian countries such as Hong Kong, China, Korea and Taiwan. While headline consumer price inflation has thus far been lower in northern Asia than in southern Asia, there are some signs that food and energy costs are filtering through into higher prices (although not to the extent as in the West). Asian regional economic growth has been more robust (especially in Singapore and Vietnam), but should the United States and Europe descend into a recession then there would be an inevitable slowdown in exports from north Asia.

Renewables, EV, infrastructure and financials

The fund is built on stock-specific merits rather from a top-down perspective. There are, however, some themes or areas of interest for the managers in the portfolio. One example is the transition to net zero will be a long-term, multi-decade journey. As value managers they are looking to access this theme not by investing in the producers of electric vehicles (EVs), which trade on excessively high valuations with insufficient or no yield, but by investing in the picks and shovels or enablers of EVs: renewable energy, artificial intelligence and cloud service providers. These companies are likely to be chip manufacturers (Taiwan Semiconductor Manufacturing Company; TSMC), basic material miners (Rio Tinto) and those financials providing renewable infrastructure finance (Macquarie). While raw material and energy prices have rolled over recently, the demand is likely to be there for many decades to come especially for lithium, copper and nickel, which are critical for EV and energy transition technology. TSMC, Rio Tinto and Macquarie all provide a combination of high or growing dividend yields, fulfilling the fund’s income objective while providing diversification from purely the end EV use. Their three-year share price correlations to Tesla are 0.37, 0.11 and 0.50, respectively. While all three stocks have lagged Tesla’s 130% return over the last three years (to the end of October, in pounds sterling), the annualised volatility of Tesla’s share price over the last three years has been over twice that of TSMC, Rio Tinto and Macquarie. Tesla trades on a trailing price-to-earnings ratio of around 70x versus the blended simple average of TSMC, Rio Tinto and Macquarie of 10.6x.

Exhibit 3: Top 10 holdings (as at 31 October 2022)

			Portfolio weight %	
Company	**Country**	**Sector**	**31 October 2022**	**31 October 2021***
Woodside Energy Group	Australia	Energy	4.7	N/A
BHP Group	Australia	Basic materials	4.4	N/A
Macquarie Group	Australia	Financial services	4.3	3.9
Santos	Australia	Energy	4.0	N/A
Digital Telcos Infrastructure Fund	Thailand	Fund	3.6	N/A
United Overseas Bank	Singapore	Financial services	3.5	N/A
Telkom Indonesia Persero	Indonesia	Telecommunications	3.3	N/A
Macquarie Korea Infra Fund	Korea	Fund	3.3	3.9
HKT Trust & HKT	Kong Kong	Telecommunications	3.2	N/A
Rio Tinto	Australia	Basic materials	3.2	N/A
Top 10 (% of holdings)			**37.5**	

Source: HFEL, Edison Investment Research. Note: *N/A where not in end-October 2021 top 10.

Another theme that the managers like is South Korean telcos (KT Corporation and SK Telecom), which are providing an attractive combination of double-digit earnings growth and high yields (c 6%) while trading on low price-to-earnings and price-to-book ratios. Telcos are traditionally deemed to be defensive although they struggled during 2020 as lockdowns removed the revenues that they normally collect via roaming. With COVID-19 restrictions being eased and the development of 4/5G coverage through the region, the managers see potential upside for margins and earnings, especially as much of the infrastructure spend has been completed.

Exhibit 4: Portfolio sector exposure vs MSCI Asia Pacific ex Japan (% unless stated)

	Portfolio end-October 2022	Portfolio end-October 2021	Change (pp)	Index weight	Active weight vs index (pp)
Financials	27.0	26.2	0.8	24.0	3.0
Communication services	17.8	20.6	(2.8)	7.4	10.4
Energy	13.6	13.2	0.4	4.7	8.9
Real estate	12.6	8.8	3.8	3.9	8.7
Basic materials	11.6	12.6	1.0	8.5	3.1
Technology	7.3	7.1	0.2	18.7	(11.4)
Consumer discretionary	5.9	5.7	0.2	12.1	(6.2)
Industrials	3.3	1.9	1.4	6.6	(3.3)
Utilities	1.0	0.9	0.1	3.1	(2.1)

Source: HFEL, Edison Investment Research. Note: *N/A where not in end-September 2021 top 10.

Financials are the largest sector weighting in the portfolio. Interest rates have risen higher than Kerley had previously thought likely and so the managers have been reducing some of the bank positions, favouring those based in south Asia that are seeing credit and stronger economic growth, such as United Overseas Bank in Singapore and Bank Mandiri in Indonesia. The managers like insurers, seeing them as a long-term structural growth story driven by a growing middle class, with CITIC Securities and AIA Group examples. Finally, infrastructure spending is likely to be a significant and long-term trend and the portfolio has a holding in Macquarie Group, which provides finance to such schemes and also has exposure via the Macquarie Korea Infrastructure Fund, which invests to develop the country's road, rail, port and energy infrastructure.

At the country level, Australia is the highest absolute position. This is predicated not on the outlook for the Australian domestic economy, which faces pressures, rather on the managers' positive views for energy and commodities prices, which they believe will be in demand for many years to come to meet the demand for renewable energy technology and infrastructure. All of the Australian listed stocks, with the exception of Dexus (REIT) and Macquarie (renewable finance), are either basic materials companies, such as Oz Minerals, or involved with energy such as Woodside Energy Group.

Exhibit 5: Portfolio geographic exposure vs MSCI Asia Pacific ex Japan (% unless stated)

	Portfolio end- October 2022	Portfolio end- October 2021	Change (pp)
Australia	26.2	25.4	0.8
China	15.4	14.9	0.5
South Korea	14.3	13.8	0.5
Singapore	12.3	11.9	0.4
Hong Kong	7.1	6.9	0.2
Taiwan	6.6	6.4	0.2
Indonesia	6.3	6.1	0.2
Thailand	3.6	3.5	0.1
Vietnam	3.2	3.1	0.1
New Zealand	3.1	3.0	0.1

Source: HFEL, Edison Investment Research

Rising interest rates and slowing demand have caused long-duration growth assets to sell off, which has resulted in a reduced weighting to Taiwan, which has a significant exposure to technology companies. Recent results in the technology sector suggest weaker consumer demand, a build up in inventories and diminishing margins. There are still Taiwanese technology holdings in the portfolio, such as TSMC and Hon Hai Precision Industry. However, the managers currently prefer South Korea, which is at an overall valuation discount and is populated via holdings in the Macquarie Korean Infrastructure Fund, SK Telecom, KT Corporation, KB Financial Group and LG Corporation.

The weighting to China has fluctuated within the fund but, over the past 12 months, it has detracted. With all of the uncertainties discussed earlier, and despite the value on offer, China is an uncomfortable place to be invested in with little respite from negative sentiment. The managers are seeing an opportunity in domestic consumption, with local brands maintaining and taking market share. This is happening across industries such as EVs, high-speed rail transport and sports/leisurewear. A recent addition was Midea Group, which is an electrical appliance manufacturer with a strong brand, strong balance sheet and was trading on an attractive price following a sharp fall. The managers expect the trend for consumers to prefer domestic brands to continue and have used market volatility to build up positions in such opportunities.

Relatively resilient performance over the last year

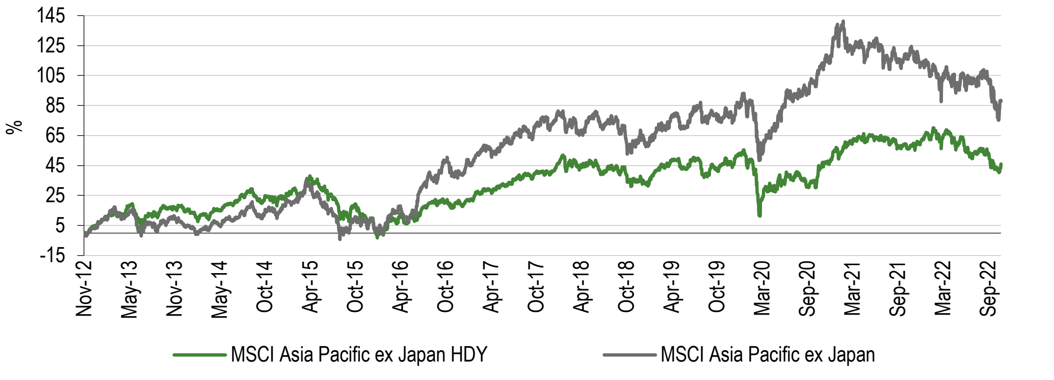
Exhibit 6: Five-year discrete performance data (%)

12 months ending	Total share price return	Total NAV return	MSCI AC Asia Pac ex-Jpn	MSCI AC Asia Pac ex-Jpn HDY	MSCI AC World
31/10/18	(4.4)	(5.6)	(8.4)	(2.5)	(1.6)
31/10/19	12.5	13.3	12.8	7.9	6.9
31/10/20	(14.7)	(10.8)	12.2	(8.4)	(20.2)
31/10/21	12.1	9.5	9.5	15.4	36.0
31/10/22	(19.2)	(11.7)	(17.8)	(5.8)	(1.6)

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

As we have previously discussed, HFEL can be compared to a variety of comparators. A widely used core benchmark for the regional generalist investment strategies is the MSCI AC Asia Pacific ex Japan Index. However, given the income objective for the company another relevant comparator could be the MSCI Asia Pacific ex Japan HDY Index. There are significant differences between these two indices, and especially so since the beginning of 2016 (Exhibit 7), but both are relevant yardsticks by which to judge the fund's performance.

Exhibit 7: Divergent performance between the two indices since 2016

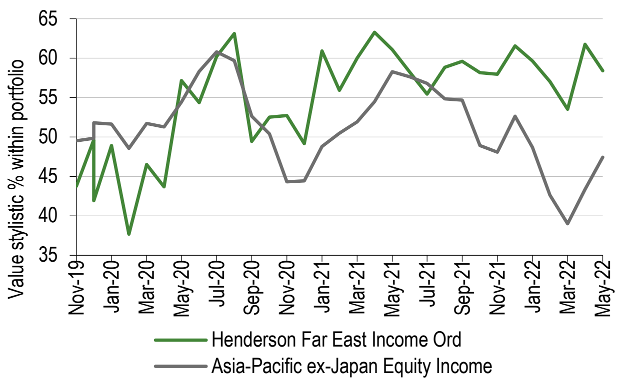


Source: Morningstar

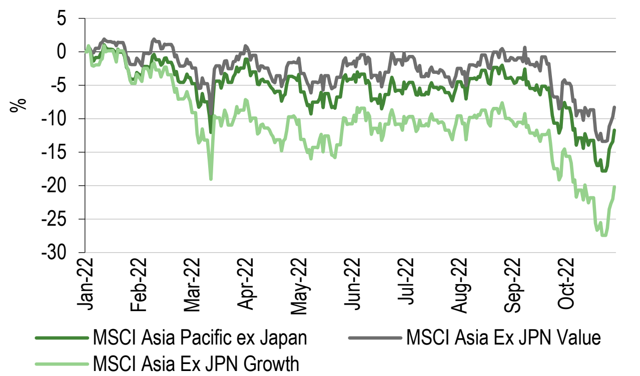
In the 12 months to the end of October 2022, the HFEL's NAV (pound sterling total return with debt at fair value cum income) returned -11.7%, which compares with the MSCI Asia Pacific ex Japan Index return of -17.8% and the MSCI Asia Pacific ex Japan HDY Index return of -5.8%. The Morningstar Asia-Pacific ex Japan Equity Income peer group returned -10.6% over this period. Asian value indices declined by -12.9%, while Asian growth stocks returned -28.6% over the period. The portfolio exposure to value stocks was a significant tailwind for relative performance over this period. At 30 June, HFEL (using Morningstar definitions) had 58% of the portfolio in value stocks compared with around 35% in the MSCI Asia Pacific ex Japan Index and 73% in the MSCI AC Asia Pacific ex Japan HDY Index. Peers (Asia ex Japan Equity Income) as calculated by Morningstar were on average only 47% exposed to value stocks.

Exhibit 8: HFEL stylistic exposure and respective style performance

Value exposure within HFEL



Growth vs value performance 2022 YTD return performance (%)

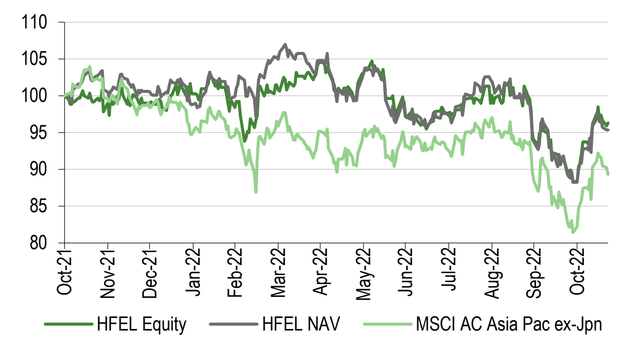


Source: Refinitiv, Edison Investment Research, Morningstar

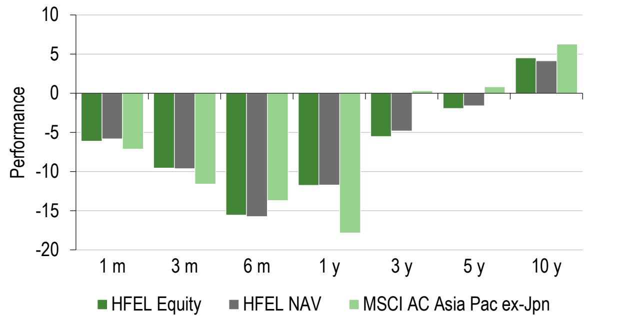
HFEL's returns were buoyed by the increased weighting to the energy, materials, telecommunications and financial sectors over 12 months to the end of October. Holdings such as Woodside Energy, BHP Group, KT Group and United Overseas Bank all delivered strongly positive returns. The fund was also a beneficiary of BHP's takeover offer for copper miner OZ Minerals in August at a 30% premium to OZ Minerals' undisturbed price. On the other hand, the fund's weighting to consumer cyclicals, technology and China in general detracted, with notable weakness in China Yongda Automobiles, JD.com and TSMC.

Exhibit 9: HFEL's performance to 9 November 2022

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: High yield and low correlation

HFEL stands out within the AIC Asia Pacific Equity Income peer group for its high dividend yield and history of trading close to its NAV when compared with peers. HFEL has lower price to free cash flow, price-to-book and price-to-earnings multiples in aggregate than its AIC peers. Overall, the value metrics within the portfolio give it an overt value tilt when compared with peers. In terms of sectors, this is illustrated with more energy, telecommunications and financials in the portfolio and less technology. This gives the portfolio a point of difference and offers valuable diversification from peers or a strategy unencumbered by an income requirement. The historical (10-year) correlation of HFEL's returns are 0.77 when compared to the MSCI AC Asia Pacific ex Japan Index and are lower than the AIC peer group average of 0.84 and the Morningstar Asia-Pacific ex Japan Equity Income peer group correlation of 0.88. By way of comparison, the Morningstar Asia ex Japan Equity peer group has a correlation of 0.97 with the MSCI AC Asia Pacific ex Japan Index. A correlation of 1 indicates a historical close relationship between two data sets, so the smaller the number the more historical variance or diversification.

Exhibit 10: AIC Asia Pacific Equity Income peer group at 22 November 2022*

% 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	412	(6.9)	(6.4)	(0.8)	61.3	1.01	N/A	4.0	102	9.0
abrdn Asian Income Fund	370	(5.0)	21.3	24.5	84.7	0.97	N/A	-9.0	111	4.5
Invesco Asia Trust	207	(6.8)	30.8	24.6	178.1	0.97	N/A	-13.3	104	5.0
JPMorgan Asia Growth & Income	326	(13.4)	10.4	13.3	136.1	0.77	N/A	-9.4	103	4.8
Schroder Oriental Income	655	(1.0)	20.0	26.0	123.4	0.86	YES	-3.8	105	4.2
Simple average (five funds)	394	(6.6)	15.2	17.5	116.7	0.91	N/A	-6.3	105	5.5
HFEL rank in peer group	2	3	5	5	5	5		1	5	1

Source: Morningstar, Edison Investment Research. Note: *Performance at 22 November 2022 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets.

Dividends: Showing resilience

With a current yield of 9% HFEL is the highest yielding fund in the AIC Asia Pacific Equity Income peer group. For FY22 the fund paid dividends per share of 23.80p on revenues per share of 24.41p (FY21: 23.40p). This surplus allowed the manager to add £1m to revenue reserves, which ended FY22 at £26.6m (or 17.1p per share), while distributable reserves in total were £180.4m (85.8p per share). The fund's revenue from dividends increased 9.2% versus the previous year, with the option premium falling by 5.8%, leaving total income up 8.0% and revenue per share up 5.1%. The fund's energy and basic materials holdings have contributed substantially to the increase in portfolio revenue, with rising spot and raw material prices. The managers are seeing increasing payout ratios across differing sectors and countries supported by increasing cash flows and solid balance sheets.

A significant tailwind for the income was the translation effect of the devaluation of sterling, without which the dividend may not have been covered. Like the best income funds, there is a blend of high dividends and lower, faster growing payments in the fund. Historically there have been high sustainable yields from Australia (although mining related dividends may have peaked for this leg of the cycle) and Singapore, which have been complemented by growth in dividends from Chinese and Taiwanese companies. The managers are hopeful that as China eventually fully reopens, this will give further support to dividends in the region.

Investment process: Undervalued, reliable income

HFEL uses a consistent and disciplined approach to build a portfolio of c 40–60 stocks from across the Asia-Pacific region. The managers seek cash-generative companies with good growth prospects that are trading at attractive valuations given the expected cash flows. They then look to blend holdings within the portfolio 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%.

The resultant portfolio sits some way between the MSCI Asia Pacific ex-Japan and HDY indices in terms of valuation on P/B and P/E measures, but has estimated dividend per share growth ahead of both indices and earnings per share growth comfortably ahead of the HDY index and in line with the Asia Pacific ex-Japan Index, a combination that should be able to perform if either growth or value factors are in favour.

HFEL: The fund managers

Mike Kerley, who has been managing Asian funds since 1993, joined Henderson Global Investors (now Janus Henderson Investors) in 2004 and was appointed as fund manager to this portfolio in 2007. Before Henderson, Kerley was a director of Pacific Basin equities at ISIS. He began his career in 1985 at Invesco Asset Management, working in operations and then from 1993 as a trainee/portfolio manager for Asian, global and emerging market equities. Sat Duhra is a fund manager on Janus Henderson Investors' Asia ex-Japan equity team. He joined Janus Henderson in 2011, before which he was an equities analyst at Nomura and Credit Suisse. Kerley and Duhra are co-managers of the Janus Henderson Asian Dividend Income strategy, of which HFEL is the closed-ended iteration, sharing similar characteristics and holdings.

HFEL's approach to ESG

HFEL is not a positive impact fund nor does it exclude investments (aside from munitions) purely on ESG considerations. Rather, the focus is on engaging with company management to promote the benefits for all stakeholders of doing the right thing. HFEL is managed in accordance with Janus Henderson's corporate ESG principles. To quote from the firm's 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.

The managers do not exclude any sector from HFEL on ESG grounds, with the exception of munitions. They say 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, there are some areas where 'it will get worse before it gets better'. Kerley 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 that this has more impact than excluding the sector and hoping that someone else will hold them accountable.

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