Murray Income Trust

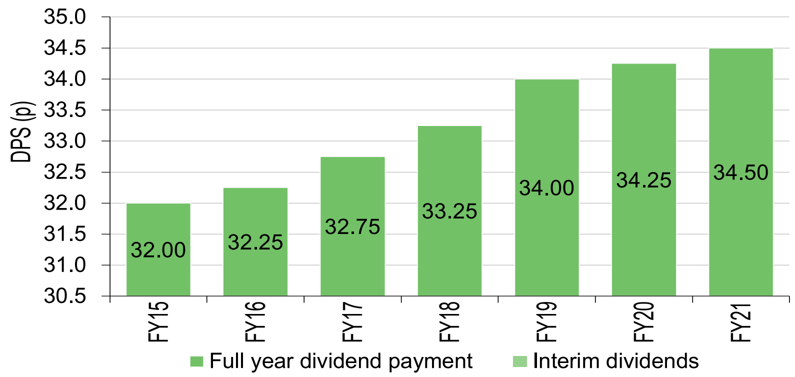
A happy anniversary for shareholders

Investment trusts
UK equity income

10 December 2021

Murray Income Trust (MUT) has just marked the first anniversary of its merger with Perpetual Income & Growth Investment Trust (PLI). This merger doubled the trust's assets under management, improved the liquidity of its shares and delivered a significant reduction in its already competitive fee. MUT invests mainly in UK equities and aims to provide a high and growing income, combined with capital growth. Its quality bias ensured that its revenues proved very resilient during the pandemic, despite widespread dividend cuts. This allowed MUT to deliver its 48th consecutive year of increased annual dividends in 2021 and the board is expecting to maintain this record in future. The current dividend yield is 4%. After a rare and brief period of underperformance in late 2020 and early 2021, recent performance has improved. MUT has also outperformed the broad UK market over the longer term, delivering an annualised average return of 8.8% on a NAV basis and 8.0% in share price terms, compared to a market return of 7.3% over the past 10 years.

Maintaining a long-term record of growing dividends



Source: Refinitiv, Edison Investment Research

Why consider the UK market now?

There are reasons to be cautiously optimistic about the UK's economic outlook and the UK market is attractive on a relative basis (see details on pages 2–3). Good-quality companies may be subject to takeover bids by private equity investors and competitors, including foreign investors, which remain underweight the UK market. Moreover, the dividend yield for the UK market is attractive relative to other markets, and to other asset classes.

The analyst's view

MUT's 48-year run of annual dividend growth, delivered via quarterly dividend payments, may appeal to Investors seeking a reliable, regular and rising income. The trust's capacity to use revenue and capital reserves to maintain this record, if necessary, may provide further comfort to such investors. MUT's performance record and well-diversified portfolio may appeal to those wanting broad exposure to the UK market, at a competitive fee. The recent widening of the discount may provide an attractive entry point.

NOT INTENDED FOR PERSONS IN THE EEA

Price Ord.	**903p**
Market cap	**£1,055m**
AUM	**£1,149m**

NAV*	977.5p
Discount to NAV	7.6%

*Including income. At 8 December 2021.

Yield		3.8%
Shares in issue		116.9m
Code Ord/A-share		MUT
Primary exchange		LSE
AIC sector		UK Equity Income
52-week high/low	952.0p	794.0p
NAV** high/low	999.4p	842.5.0p

**Including income.

Gearing

Net gearing at 26 Nov 2021	9.5%

Fund objective

Murray Income Trust (MUT) aims for a high and growing income combined with capital growth through investment in a portfolio principally of UK equities. Its investment policy is to invest in companies that have potential for real earnings and dividend growth, while also providing an above-average portfolio yield. The emphasis is on the management of risk and the absolute return from the portfolio. MUT measures its performance versus the broad UK stock market.

Bull points

- A well-established track record of outperformance of the market and peers.
- The recent widening in MUT's discount may represent an attractive entry level.
- A very competitive fee.

Bear points

- The manager is making only limited use of his mandate to invest up to 20% of gross assets in foreign stocks. This conservative approach may be a drag on performance and reduces exposure to the diversification benefits of holding foreign shares.
- MUT's gearing level increases its vulnerability to any market downturn.
- The UK market may remain out of favour with investors.

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Edison profile page

Murray Income Trust is a research client of Edison Investment Research Limited

MUT/PLI merger: A happy anniversary indeed

MUT has just celebrated the first anniversary of its merger with PLI, which doubled its net assets to around £1.0bn, sufficient to ensure its membership of the FTSE 250. MUT is now one of the largest trusts in its AIC peer group, which comprises 20 trusts (see Peer group comparison section for more details). This increase in assets under management has allowed MUT to be included in more buy lists and trading volumes in MUT's shares have increased. The bid-offer spread at which the trust's shares trade has approximately halved, so it is now cheaper for investors to buy MUT's shares.

MUT's fees and charges have also fallen following the merger. The company's blended management fee was 0.39% for the year to end June 2021, with the relevant fee calculated without deducting the manager's non-recurring fee waiver. This compares to a pre-merger rate of 0.48%, and 0.55% for PLI. MUT's ongoing charge ratio has fallen accordingly, from 0.64% pa to 0.46% as at end June 2021, making it one of the lowest fees in the AIC peer group. As MUT's chairman, Neil Rogan, recently observed, these kinds of reductions in fees and charges would normally take 10 years to achieve.

The manager's view: Resilient income focus pays off

MUT has recently passed another milestone. Despite widespread cuts to dividend payments by many companies following the onset of the coronavirus crisis, 2021 is the 48th consecutive year in which MUT has increased its annual dividend payment (see chart on page 1). MUT's manager, Charles Luke, maintains that his longstanding focus on companies with resilient income and strong balance sheets has been working especially well during the pandemic, protecting the revenue account and the trust's 'dividend hero' status.

Luke seeks quality companies with a record of adapting successfully to change and most of MUT's holdings seem to be doing just that. The manager is pleased that nearly all MUT's portfolio holdings that suspended dividends during the height of the pandemic have now resumed payments. A number have even paid catch-up dividends and others that maintained dividend payments have increased them.

This improvement in MUT's income receipts is well ahead of expectations for the market as a whole. Link Group, a company which monitors dividend payments, forecasts that across the UK market, income-generated returns are not set to return to pre-pandemic levels until 2025. However, Luke expects MUT's earnings per share to surpass pre-pandemic levels well ahead of this schedule, in the current financial year ending June 2022, helped in part by what he refers to as 'bumper dividends' from the portfolio's holdings in Rio Tinto and BHP.

Luke believes the case for a focus on dividends is as strong as ever. Dividend growth is a key driver of equity returns and, in his view, even once the Bank of England begins to raise interest rates, any increases will be small and will not solve the income dilemma faced by many investors. 'It will still be difficult to get attractive returns from a savings account or from government bonds', he says. In addition, for Luke, dividends remain 'the touchstone measure of a company's quality'. 'If a company is striving to grow its dividend, it should, from necessity, be investing wisely and acting prudently', says Luke. In his recent engagements with companies, Luke is pleased to report that management teams seem noticeably more confident in their ability to grow dividends over the longer term.

Luke is equally positive about the longer-term potential of MUT's portfolio to deliver an appealing, sustainable and growing income stream for shareholders. His view is that this should be supported by an improvement in the economic outlook, which he believes is much more favourable than at the time of our last note. The manager now foresees several years of above-trend global growth, aided by vaccine roll-outs, ongoing accommodative fiscal and monetary policy and significant pent-up demand in the wake of the pandemic. For the UK market, he sees as further positives the nation's stable government, one of the world's fastest vaccine roll-outs and the fact that the significant uncertainties that preceded Brexit are now 'in the rear-view mirror'.

Moreover, foreign investors remain underweight the UK market and, in Luke's view, the valuations of UK-listed companies remain attractive on a relative basis. He cites the dividend yield on the UK market (currently at 3.2% according to Datastream), which remains at an appealing premium to other regional equity markets, 'let alone other asset classes'. The UK market is also trading at an historically wide discount to the world market on a one-year forward price/earnings (P/E) basis, and Luke believes that at these levels, many companies may attract the attention of international private equity investors and become the target of takeover bids. Also, this is particularly the case for many of MUT's holdings, he argues, as private equity purchasers often look for the same quality characteristics in potential acquisitions that MUT targets. 'We think a fair proportion of the portfolio may be vulnerable to corporate activity', he says. He cites as two recent examples the bids for portfolio holdings John Laing, an infrastructure company, and Sanne, a fund administrator, mid-year, and expects to see further bids over the coming months.

Exhibit 1: Top 10 holdings (as at 31 October 2021)

Company	Country	Industry	Portfolio weight %	
			31 October 2021	31 October 2020*
AstraZeneca	UK	Healthcare	5.1	4.4
Diageo	UK	Consumer goods	4.8	3.5
RELX	UK	Media	3.7	3.2
SSE	UK	Utilities	2.9	N/A
Standard Chartered	UK	Financials	2.7	N/A
Coca-Cola HBC	Switzerland	Beverages	2.6	N/A
TotalEnergies	France	Oil & gas producers	2.5	N/A
Safestore	UK	Industrial REIT	2.5	N/A
Unilever	UK	Consumer goods	2.5	3.8
Close Brothers	UK	Banks	2.5	2.7
Top 10 (% of portfolio)			**31.8**	**33.3**

Source: Murray Income Trust, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-October 2020 top 10.

In the meantime, the manager is continuing his efforts to improve the quality of MUT's portfolio, and strengthen its focus on capital and dividend growth, by taking advantage of attractive investment opportunities as they arise. To this end, he says that trading over the past financial year, and more recently, has been driven by a desire to reduce exposure to some of the largest companies in the market and a willingness to increase the active share of the portfolio, which is now approximately 70%. For example, Luke has closed a position in the pharmaceutical giant, Roche, due to concerns about a more challenging pricing environment and he has trimmed positions in Microsoft and Nestlé, and more recently, National Grid, an electricity provider, metals and mining companies, Rio Tinto and BHP, AstraZeneca, a pharmaceutical company, and beverage supplier Diageo, although these latter two names remain the portfolio's two largest holdings (Exhibit 1).

Other outright sales have included Big Yellow, an industrial REIT. Proceeds of this sale were re-invested in Big Yellow's peer, Safestore, which Luke believes has better long-term growth opportunities due to its European exposure. Safestore is now a top 10 holding. In September, Luke sold Softcat, a UK value-added IT reseller and IT infrastructure solutions provider. This position was opened during the last financial year and subsequently saw a sharp increase in its share price. It began to look expensive, so the manager took profits. Luke also took profits, then subsequently closed, a position in LondonMetric Property, which performed strongly, to the point where its valuation and dividend yield were no longer compelling. In September, Luke sold Sanne, in response to a recommended offer for the company (mentioned above).

The manager also took some profits, reducing exposure to a number of other companies that had performed strongly, leaving valuations less attractive. Positions trimmed included Assura, a healthcare facilities REIT, and Close Brothers bank.

The proceeds of these full or partial sales have been used to increase exposure to a number of existing holdings, including Vistry, a housebuilder which Luke added to the portfolio earlier in the year. This company has an attractive dividend yield and the manager believes that the market valuation does not fully reflect the significant growth potential of Vistry's partnership business, which collaborates with local authorities and public housing associations on regeneration projects. The manager has also topped up several other positions with exposure to housebuilding, including in Marshalls, a building materials company, Howden Joinery, a kitchen supplier, Watkin Jones, a developer of student accommodation and OSB Group, a mortgage finance provider.

Positions in DS Smith and Sage were also increased in September. DS Smith is a paper and packaging company with improved quality characteristics. Luke believes the market does not fully appreciate the extent to which the company will benefit from an increase in structural demand, as the need for plastic alternatives rises, and as e-commerce increases the demand for packaging. Sage is a software publishing company which offers good growth prospects, high and growing margins and a strong balance sheet, at an attractive valuation.

MUT's most recent new acquisition is Drax, a renewable energy company. The manager opened the position in September and increased it in October, as he sees upside potential from developments in bioenergy with carbon capture and storage (BECCS) and higher power price optionality. The company also offers an attractive dividend yield.

It is clear from this list of transactions that portfolio activity is not driven by one theme or economic scenario. In Luke's view, recent events have shown the importance of diversification, and this remains one of MUT's guiding principles. Portfolio diversification is assisted by the trust's international holdings, which Luke believes are especially helpful in some sectors such as technology, which provide MUT with exposure to some of the world's largest and most innovative companies, such as Microsoft, not available in the UK market (see Exhibit 2).

Exhibit 2: MUT's overseas holdings as at 30 November 2021

Company	Country	Sector	% of portfolio end Nov 2021
TotalEnergies	France	Oil & gas producers	2.5
Novo-Nordisk	Denmark	Pharmaceuticals & biotechnology	1.8
Nordea	Finnish	Financials	1.4
Microsoft	USA	Software & computer services	1.4
Nestlé	Switzerland	Food producers	1.3
VAT Group	Switzerland	Industrial engineering	1.2
Telenor	Norway	Mobile telecommunications	1.1
Kone	Finland	Industrial engineering	1.0
Mowi	Norway	Industrial engineering	0.6
Accton Technology	Taiwan	Telecommunications equipment	0.5
Total non-UK exposure			**12.8**

Source: Murray Income Trust, Edison Investment Research

The trust can invest 20% of gross assets overseas, and at the end of the financial year 11.0% of the portfolio was invested in non-UK companies. As discussed in our last note, the manager recently acquired MUT's first Asian name, Accton Technology, a Taiwanese network equipment technology company. This company offers a degree of exposure to global growth in data centres and internet traffic which is difficult to find in the UK market. Since the end of the financial year, the trust has also added an exposure to Nordea Bank, a high-quality Nordic bank with an attractive yield.

The manager's efforts to diversify the portfolio also extend to option writing, which provides the portfolio with an uncorrelated income stream, while also increasing available income modestly. In the financial year to end June 2021, option income decreased to 7% of total income compared to 10.8% during the previous year. The trust currently has 12 covered call option positions, including calls on Coca-Cola HBC, Euromoney, Inchcape and Sirius Real Estate. This compared with a total of 12 short call positions in May 2021.

Exhibit 3: Portfolio sector exposure* versus benchmark (% unless stated)

	Portfolio end-October 2021	Portfolio end-October 2020	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Industrials	17.3	12.5	4.7	13.0	4.3	1.3
Financials	16.7	22.0	(5.3)	23.1	(6.4)	0.7
Consumer goods	12.7	16.6	(3.9)	14.5	(1.8)	0.9
Healthcare	11.7	15.3	(3.6)	10.1	1.6	1.2
Consumer services	10.2	7.2	3.0	12.2	(2.0)	0.8
Basic materials	8.3	11.0	(2.7)	9.0	(0.7)	0.9
Utilities	6.5	5.1	1.3	3.0	3.5	2.2
Real estate	6.5	0.0	6.5	3.2	3.3	2.0
Technology	4.4	4.2	0.2	1.6	2.9	2.9
Energy	4.2	2.9	1.4	8.5	(4.3)	0.5
Telecommunications	1.5	3.1	(1.6)	1.9	(0.3)	0.8
	100.0	**100.0**		**100.0**		

Source: Murray Income Trust, Edison Investment Research. Note: *Adjusted for cash.

In total, at the end of October 2021, portfolio holdings totalled 61, unchanged from end March 2021. The trust had notable overweights in industrials, utilities, real estate and technology, while its largest underweights were to financials and energy (Exhibit 3). As a reflection of the manager's confidence in the portfolio's prospects, he has increased gearing to 9.5% at 26 November 2021, from 5.3% at the end of June 2020. Annualised portfolio turnover stood at 21% at end September 2021, close to the five-year average of 20%. At the end of October 2021, the portfolio's forward P/E was 16.1x, compared to 12.7x for the UK market, which Luke argues 'is a small price to pay for a higher quality portfolio'.

Performance: Returning to form

Exhibit 4: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	CBOE UK All Companies (%)	MSCI UK High Dividend Yield (%)	MSCI AC World (%)
30/11/17	12.0	12.9	13.7	16.7	15.7
30/11/18	(0.4)	0.1	(1.8)	(0.7)	5.6
30/11/19	23.1	18.2	11.3	7.3	12.8
30/11/20	(1.1)	(5.4)	(11.2)	(14.4)	12.0
30/11/21	11.6	19.3	17.1	8.1	20.9

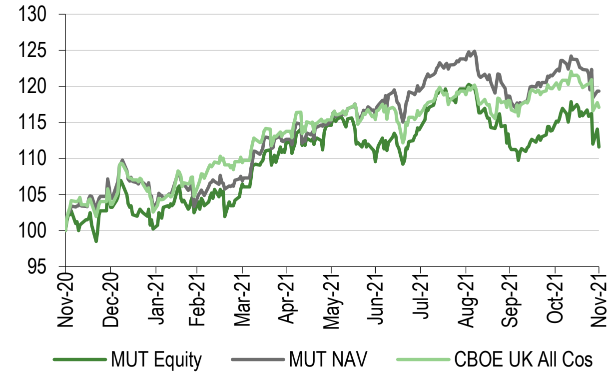
Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

MUT experienced a brief and rare period of underperformance in late 2020 and early 2021. The portfolio's quality holdings lagged in the rotation into lower-quality cyclical and value stocks following the announcement of viable vaccines. However, recent performance has improved in absolute and relative terms, as the value rally failed to sustain momentum. In the six months to November 2021, the trust returned 3.6% in NAV terms, compared to the broad UK market (as measured here by the CBOE UK All Companies index), which returned 1.5%. On a share price basis, MUT did less well, dropping by 2.6%, widening the share price discount, to around 8.0% at end November, from 1.3% at end May 2021. In addition, MUT's longer-term performance has been good. It has outperformed the UK market (Exhibit 5) on both a NAV and share price basis over three, five and 10 years, making an average annualised return of 8.8% in NAV terms and 8.0% on a share price basis over 10 years, compared to a market return of 7.3 The trust's performance has outpaced the average return of its AIC sector peers over three and five years and almost matched it over 10 years (Exhibit 6).

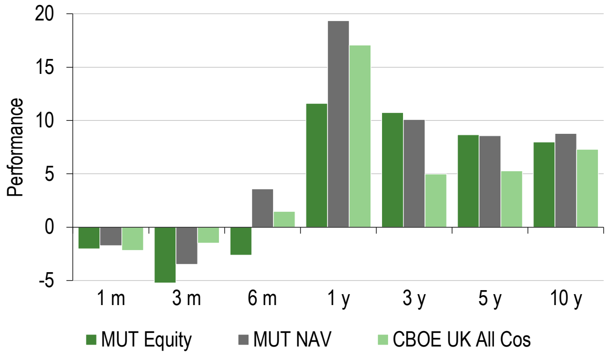
The trust's risk-adjusted returns have also been strong. In November, the trust received the Citywire award for the UK equity income investment trust with the highest risk-adjusted returns over a three-year period. This is the second year in succession that MUT has won this award, which judges risk-adjusted performance using information ratios (IRs). IRs measure investment returns generated for each unit of risk taken against the benchmark. An information ratio up to 1 is considered a good result. MUT's information ratio in the three years to end August 2021 was 1.36x.

Exhibit 5: Investment company performance to 30 November 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.

At the stock level, the main contributors to relative returns over the six months to end October were an overweight to Safestore, an industrial REIT, mentioned above, and out-of-index positions in VAT Group, a Swiss industrial engineering firm, Novo Nordisk, a Danish pharmaceuticals company, and TotalEnergies, a French oil and gas supplier. The portfolio's overweight positions in Croda International, a UK chemicals manufacturer, and RELX, a UK business analytics company, among others, also enhanced performance. The positive influence of these holdings on relative returns was only partially offset by the adverse impact of the portfolio's lack of exposure to Royal Dutch Shell, an oil and gas producer, Glencore, a metals and mining company, Ashtead Group, an industrial rental and leasing business, and Experian, a credit rating agency. An overweight to asset manager Ashmore Group and an underweight to GlaxoSmithKline, a drug manufacturer, also detracted from relative returns.

At the sectoral level, the manager's asset allocation decisions contributed to relative performance across most sectors in the six months to end October. The largest contributions to returns came from an underweight to consumer goods and overweights to real estate, utilities, technology and healthcare. The portfolio's underweights to energy and financials and an overweight to industrials detracted modestly.

Peer group comparison

MUT is a member of the AIC's UK Equity Income sector, which comprises 20 funds, although it is differentiated from many of the constituents of this sector in several respects. While MUT is focused on companies with high-quality characteristics, several of its peers have a more value-oriented investment approach. MUT's portfolio is more diversified than some, across sectors, stocks and geographies, as around a third of its portfolio is invested in mid-cap stocks and more than 10% is held in international stocks. The manager also seeks to supplement and diversify income sources with modest option writing.

MUT's merger with PLI, in November 2020, doubled its market capitalisation, making it the fourth largest fund in this sector (Exhibit 6). As discussed above, in late 2020 and early 2021, its relative performance lagged that of its more value-focused peers such as Law Debenture, Lowland and Merchant Trusts (all Edison clients), as well as Temple Bar and other peers such as Diverse Income Trust (also an Edison client) with a small-cap bias, as these trusts outperformed during the rotation into cyclical and value stocks. This has reduced MUT's performance ranking over one year, although performance has improved recently and returns over longer periods still compare favourably with the average of its peers. This is due in part to the fact that MUT's quality growth approach, which it shares with peers such as Finsbury Growth & Income Trust (an Edison client) and Dunedin Income Growth, was in favour with investors for many years before the recent rotation into value stocks. MUT is ranked fourth in performance over three years, third over five years and ninth over 10 years.

Following the post-merger decline in its ongoing charge to 0.46% (as at 30 June 2021) MUT's charge is even more competitive – it is now the third lowest in the peer group. Like all its peers, MUT does not pay a performance fee. The trust's share price discount to cum-income NAV narrowed sharply following news of the merger with PLI and its shares traded at a small premium in October and November last year. However, as mentioned above, the discount has since drifted out and is currently at 7.6%, wider than the average of its peers. The trust's dividend yield of 3.8% (based on the current share price and the last four dividends) is just below the average. MUT's gearing is also just under the sector average.

Exhibit 6: UK Equity Income peer group as at 8 December 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
Murray Income Trust	1,055.2	19.2	41.7	54.2	138.6	0.5	No	(7.6)	110	3.8
Aberdeen Standard Equity Inc Trust	169.1	18.8	8.8	14.1	102.5	0.9	No	(8.0)	112	5.9
BlackRock Income and Growth	40.6	12.9	24.7	30.4	114.5	1.2	No	(8.1)	102	3.8
BMO Capital & Income	350.0	20.0	32.4	45.2	135.3	0.6	No	(2.3)	106	3.5
BMO UK High Income Units	118.6	8.7	24.9	25.2	98.5	1.0	No	(7.9)	111	4.3
Chelverton UK Dividend Trust	44.0	42.8	31.6	35.7	291.1	2.5	No	(5.4)	169	5.2
City of London	1,752.7	18.0	21.5	30.5	125.3	0.4	No	(0.8)	110	4.9
Diverse Income Trust	412.6	18.9	38.2	49.3	255.5	1.1	No	0.4	100	3.3
Dunedin Income Growth	483.0	12.9	43.7	52.7	128.8	0.6	No	0.5	108	4.0
Edinburgh Investment	1,086.5	21.7	18.5	21.4	129.6	0.4	No	(8.2)	110	3.8
Finsbury Growth & Income	2,036.7	12.5	34.7	69.7	264.2	0.6	No	(4.0)	101	1.9
JPMorgan Claverhouse	456.5	24.4	33.5	42.0	154.1	0.7	No	0.3	119	4.0
JPMorgan Elect Managed Inc	79.8	21.8	27.5	30.6	114.0	0.8	No	(3.4)	106	4.5
Law Debenture Corporation	951.4	25.8	43.6	62.9	187.4	0.6	No	(0.7)	122	3.7
Lowland	359.3	24.7	19.3	22.7	143.3	0.6	No	(8.2)	114	4.5
Merchants Trust	702.9	33.2	46.9	52.6	160.7	0.6	No	0.9	111	4.9
Schroder Income Growth	211.2	13.9	26.2	30.2	125.9	0.8	No	0.5	111	4.2
Shires Income	83.1	16.4	35.6	45.5	161.3	1.0	No	(4.9)	123	5.1
Temple Bar	743.0	23.7	14.1	16.4	107.8	0.5	No	(8.1)	100	3.5
Troy Income & Growth	253.7	15.0	21.5	32.2	121.9	0.9	No	(1.8)	100	1.8
Sector average (20 funds)	**569.5**	**20.3**	**29.4**	**38.2**	**153.0**	**0.8**		**(3.8)**	**112**	**4.0**
MUT rank in sector	**4**	**10**	**4**	**3**	**9**	**3****		**14**	**10**	**13**

Source: Morningstar, Edison Investment Research. Note: *Performance to 7 December 2021 based on ex-par NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared). **Denotes third lowest fee within the peer group.

Dividend policy and record

MUT aims to provide investors with a high and growing dividend, paid quarterly in December, March, June and September each year. FY21's dividend of 34.50p per share was 0.7% higher than FY20's 34.25p. (The fourth interim dividend for FY21 was declared in August 2021 and paid in September.) As discussed above, this makes FY21 the 48th consecutive year of dividend increases. The dividend was 98% covered by revenue earned. Following the dividend payment, which reduced reserves by £0.9m or 0.8pp, reserves stood at 12.9pp available to support future dividends – equivalent to 37% of the current annual dividend of 34.50pp.

In early November 2021, the board declared that the three interim dividends for the current financial year ended June 2022 (FY22) will each amount to 8.25p, taking the total to 24.75p, unchanged from the first, second and third interim dividends for FY21. The fourth interim dividend will be declared after the year end. Based on the current share price and the last four dividend payments, MUT has a dividend yield of 3.8%.

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