EDISON

Henderson Far East Income

A strong recovery in dividend income for H122

Investment trusts
Asia Pacific Equity Income

9 May 2022

Price	**298p**
Market cap	**£452m**
AUM	**£467m**
NAV*	298p
Premium to NAV	0.1%
*Including income. At 5 May 2022.	
Yield	7.9%
Ordinary shares in issue	151.7m
Code/ISIN	HFEL/JE00B1GXH751
Primary exchange	LSE
AIC sector	Asia Pacific Equity

52-week high/low	337.5p	274.5p
NAV* high/low	330.5p	279.5p
*Including income		

Henderson Far East Income (HFEL) focuses on providing investors with a high and growing level of income, with capital appreciation an important consideration within the investment objective. The trust has met these goals on a total return basis, with a dividend yield premium of around 50% over its Association of Investment Companies (AIC) peers. This is funded predominantly via underlying dividend income, which increased by 14.7% in H122 (31 August 2021 to 28 February 2022) versus H121.

Significant yield premium versus AIC peers

Source: Morningstar.

Why invest in Asian Income now?

Asia is home to some of the world's leading companies across a variety of countries and sectors and has a developing and improving dividend culture that has historically contributed around half of total investor returns in the region. The Asia-Pacific ex-Japan region suffered an 18% decline in dividends in 2020 versus 2019, but rebounded strongly by 31.7% in 2021 to create a record $163bn of payouts in 2021. This trend looks set to continue, deriving from strong earnings growth as the region recovers from COVID-19, providing investors with strong secular tailwinds for ongoing dividend growth. In addition, aggregate valuations in the region are also attractive compared to the United States and developed Europe.

The analyst's view

HFEL provides investors with a differentiated approach for accessing this dynamic and growing region. The focus on a high level of income and the associated sector and country positioning lends this portfolio a more procyclical flavour currently, with around half of it invested in cyclical sectors such as financials, basic materials and energy. HFEL also offers income investors significant diversification characteristics versus traditional UK equity income strategies.

Current discount

HFEL has historically traded between a narrow discount and a small premium to NAV over an extended period, which is narrower than its AIC category peers. This can be attributed to the attractiveness of the high level of income and the diverse shareholder base.

Gearing

Net gearing at 5 May 2022	2%

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

- Highest yielding fund among its peers.
- On track for fully covered FY22 dividend.
- Experienced portfolio management team.

Bear points

- NAV long-term performance has lagged peers.
- Income investing can be out of favour.
- Focus on yield may dampen total returns.

Analysts

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

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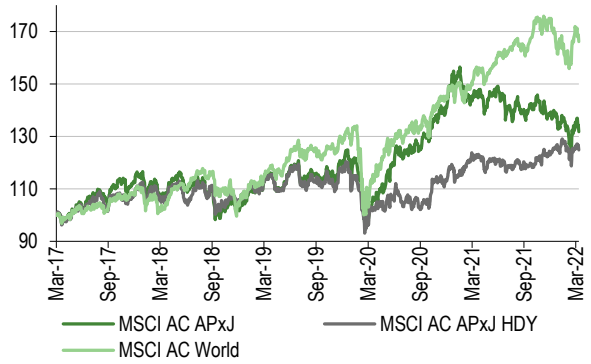
Market outlook: Inflation a risk

Inflationary pressures remain moderate in many parts of Asia compared to parts of the Western world. Although there are pressures in the energy market, food price inflation remains subdued, which can be attributed to the high levels of domestic food production and the effect that regional lockdowns continue to have on economic activity. Because of the inflationary outlook in Asia, there is less possibility of central bank policy errors than in the West. However, where there are pockets of inflation – such as in India – the focus for investors becomes even more about identifying companies with strong pricing power and which have strong balance sheets to maintain investment, profit margins and dividend payments.

In aggregate, Asian companies have an attractive combination of earnings growth and less debt than Western corporates. This is supportive of dividends, which have grown by 11.8% on average per year since the end of 2003 compared with 7.6% for developed market equities as a whole. Payout ratios vary considerably across the region, but there is scope for them to rise, which when added to earnings growth could see a higher-yielding market in aggregate.

Exhibit 1: Performance and valuation of Asian and world equity markets

Total return performance of Asia Pacific and UK equities over five years (£)



Valuation metrics of Datastream indices (at 20 April 2022)

	Last	High	Low	10-year average	Last as % of average
Asia Pacific ex-Japan					
P/E 12 months forward (x)	12.4	17.8	10.5	13.0	95
Price to book (x)	1.7	1.9	1.1	1.6	106
Dividend yield (%)	2.3	3.3	1.7	2.5	93
Return on equity (%)	11.0	14.3	18.3	11.5	96
World					
P/E 12 months forward (x)	15.7	20.0	10.6	15.2	103
Price to book (x)	2.5	2.6	1.4	1.9	129
Dividend yield (%)	2.1	3.4	1.8	2.4	86
Return on equity (%)	14.0	14.1	7.2	10.8	130

Source: Refinitiv, Edison Investment Research

The Asian dividend landscape in 2022

Over the last five years, the MSCI Asia Pacific ex-Japan and MSCI Asia Pacific ex-Japan High Dividend Yield (HDY) indices have both posted similar returns on an annualised basis, of 5.8% and 5.4%, respectively, to the end of March 2022. This has masked disparate recent returns in the respective indices, with the recovery of value stocks that had begun in late 2020 continuing through 2021. During this period, the high dividend index returned 8.1% and the more growth-orientated mainstream index returned -1.8%. Between January and March 2022, this trend is continuing with the high dividend index returning 2.9% and the main index falling 3.0%.

According to the Janus Henderson Global Dividend Index, dividends in Asia reached a new record of $163bn in 2021 after recovering from an 18% fall to $124bn in 2020 (2019: $151.4bn). Australia provided nearly 40% of regional dividends paid in 2021, while Hong Kong and Taiwan provided 28% and 14%, respectively. Australia rebounded strongly in 2021, with a mix of economically sensitive companies in banking and mining driving the recovery. Some 90% of Australian companies increased payouts, but it was the miners that excelled as commodity prices soared: BHP declared the world's largest-ever mining dividend at $12.5bn, while Fortescue Metals, Rio Tinto and Newcrest also increased payouts. Hong Kong's dividends fell in 2021 due to the troubles at property group China Evergrande, which was formerly the territory's second-largest payer. The cancellation of resort operator Sands China's dividend also affected the headline figure. In China,

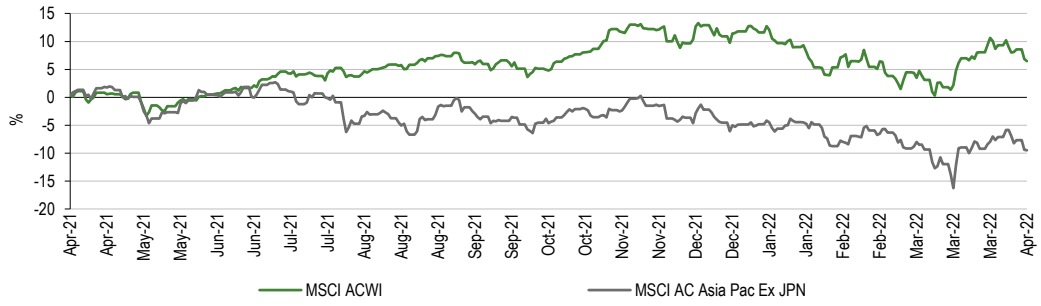
PetroChina doubled its payment and accounted for half of the country's 18.9% underlying dividend growth to a new record total of $44.6bn. However, a third of companies in the Chinese index cut or cancelled payouts, reflecting lower 2020 profits. Japanese dividends increased by 11.4% in 2021, which was behind the global average but from a higher 2020 base, with 85% of Japanese companies raising or maintaining payouts in 2021.

The fund managers: Mike Kerley and Sat Duhra

The manager's view: Dividend growth

HFEL co manager, Mike Kerley, says the Asia Pacific region continues to look attractive to income investors as earnings and dividend growth are forecast to be stronger, supported by higher GDP growth relative to the US, Europe and the UK. Asian corporates had a relatively robust COVID-19 crisis in 2020, which meant earnings growth did not bounce back as far as in some regions that saw very depressed 2020 earnings. COVID-19 disruption has proven so far to be a slight bump in the road to the longer-term GDP and earnings growth trajectory seen in Asia over the past eight years. Valuations in the region are in line with long-term averages, but potentially offer better relative value than broader global markets (Exhibit 1). Despite all of this, Asian equities have underperformed developed markets (Exhibit 2) given a combination of less central bank and government support, lower vaccination rates, the zero-COVID policy in China and associated travel restrictions, which have all dampened economic activity and investor demand for Asian equities. In addition, the regulatory clampdown in China and, more recently, the war in Ukraine, have also soured investor sentiment towards risky assets. China, which is a material element of the benchmark (28.4% at end of March 2022), has been a drag on the region's performance as a whole.

Exhibit 2: Underperformance of Asia versus MSCI ACWI over the last 12 months



Source: Refinitiv, Edison Investment Research

In China, the authorities have enacted a new social and economic policy focused on providing common prosperity for the population (via a more equal distribution of the wealth created between investors and workers). This move has unsettled investors and dampened sentiment. From a peak in February 2021, the Chinese stock market has fallen 44%, whereas global equities have gained 7%. The common prosperity measures have been targeted and impactful, for example the Chinese internet sector has declined in value by 50% in 2021 as the governing regime saw it being too influential. Other areas that were subject to additional regulation were education, healthcare and property. Free market development in these areas has been seen as a barrier to improving the demographics of China's ageing population, as they are significant costs to the household that may work against the goal of increasing the country's birth rate. Despite a return to GDP growth in 2021 of 8.5% y-o-y, fiscal stimulus is available if required; however, high levels of debt may limit the government's ability to borrow and spend on infrastructure and housing, especially as the cost of raw materials and energy have seen significant increases. The government has a 2022 GDP growth target of 5.5%, which in the managers' view is unlikely to be met without an about-turn on COVID-19 restrictions and an increase in stimulus. The IMF in its latest World Economic Outlook

(April 2022) has reduced its 2022 GDP growth forecast for China to 4.4%, from 4.8% in January 2022.

China remains a very important driver within the region but has a reduced weighting within HFEL's portfolio, with 13.6% invested at March 2022, compared with 24.1% in March 2021 and a (simple) average of 18.2% for the AIC Asia Pacific Equity Income peer group.

Asset allocation: Bias to Australia and financials

Current portfolio positioning

HFEL's fundamental investment process continues to seek out good quality (higher return on equity or ROE), valuation supported (higher free cash flow yield) companies with strong cash generation, and a policy for paying this cash to investors. The trust has a relatively concentrated portfolio based on the merit of each individual holding. Country and sector positioning will primarily result from these factors rather than a top-down investment view. From a country perspective, the portfolio is overweight (when compared to the MSCI AC Asia Pacific ex-Japan index) in Australia, South Korea, Indonesia and New Zealand and underweight Taiwan, China, Singapore and Hong Kong. At the sector level, the portfolio is more represented on a relative basis than the index in basic materials, real estate, communication services, energy, and technology, whereas it is underweight consumer cyclicals, financial services, industrials, consumer defensives and utilities.

Stock-specific merits have fed into some wider investment themes within the portfolio. Within technology, the managers prefer hardware producers such as Quanta Computer, which tend to trade at cheaper valuations than software or internet stocks and are more cash generative and higher yielding. Green energy is played via Macquarie Group, which is well positioned to provide finance to key renewable and infrastructure projects. E-commerce growth in Asia is accessed through REITs specialising in logistics, such as Mapletree Logistics Trust, which is an enabler for Asian e-commerce. In addition to these secular tailwinds, the managers have found good opportunities in financials, which are the biggest position within the portfolio, with the sector standing on attractive valuations, paying good dividends and holding better-quality loan books than previously. Key positions here include KB Financial Group in Korea and United Overseas Bank in Singapore. HFEL only owns a single Chinese bank, Industrial Bank – a smaller player than the 'big four' banks used to implement monetary policy – which specialises in SME business and wealth management, putting it in a good position to deliver sustainable ROE, according to Kerley. Overall, the managers have been reducing their exposure to banks a little as they feel the yield curve will not be as steep as previously thought. Basic materials and energy are well represented across the portfolio, as economic reopening and ESG trends have created a demand for copper, lithium and nickel for electric vehicle production. This is a very conscious decision by the managers as they believe the industry has underinvested in extraction recently, creating bottlenecks and an inelastic supply. Exposure to materials companies such as BHP Group, Santos and OZ Minerals can offset the potential effects of inflationary pressures in other parts of the portfolio. Conversely, there is only a modest exposure to industrials, which, as 'downstream' consumers of basic materials, are likely to see their cash flows squeezed by high inflation. Similar concerns serve to limit the fund's exposure to consumer stocks.

From a country perspective, the weighting to Australia has rarely been higher. The managers favour global cyclicals (basic materials/energy) over companies with domestic earnings, and are concerned about the possibility of an overheating residential housing market. However, there is a holding in real estate company Dexus, which specialises in centrally located offices. Aside from Macquarie Group, HFEL's largest four Australian domiciled holdings are BHP Group, Rio Tinto, OZ Minerals and Woodside Petroleum. In contrast, the trust is very underweight India, as the pre-COVID-19 structural issues such as weak credit growth, lack of job creation and a failure to build up

a strong manufacturing base have not been addressed, which together with high valuations, high inflation, low yields, a concentrated market and unreliable GDP numbers leads to few attractive investment opportunities. HFEL's two Indian holdings are both energy companies, including Oil & Natural Gas Corporation, which is part government owned and the managers consider is very attractively priced. Kerley and Duhra are favourable towards Vietnam, which is buoyed by supportive demographics, higher infrastructure spending, improved market liquidity and is a beneficiary of supply chain disruption in China. This theme is primarily expressed through investment in the VinaCapital Vietnam Opportunity Fund (see our latest research on this fund), which has around two-thirds of its assets invested in real estate, basic materials and financials.

Kerley is cautiously optimistic on the prospects for Asian equities, given the supportive valuations relative to other parts of the world and the robustness of earnings feeding through into growing dividends. China as ever is key, and there is scope to increase the exposure as economic stimulus grows. After some years of being out of favour, the outlook for yield over growth is also positive according to Kerley, given the expectations for higher inflation, interest rates and an ageing demographic, which should serve as a support for high and growing dividends at the expense of low-yield, long-duration assets.

Exhibit 3: Top 10 holdings (at 31 March 2022)

Company	Country	Sector	Portfolio weight %		Index weight	Active weight vs index
			31 March 2022	31 March 2021*		
Rio Tinto	Australia	Basic materials	5.1	3.5	2.4	2.7
Macquarie Group	Australia	Financial services	4.2	N/A	0.7	3.5
BHP Group	Australia	Basic materials	3.8	3.6	3.9	(0.1)
Woodside Petroleum	Australia	Energy	3.6	N/A	0.3	3.3
Samsung Electronics	Korea	Technology	3.6	4.3	4.1	(0.5)
Telkom Indonesia	Indonesia	Telecommunications	3.4	N/A	0.2	3.2
Santos	Australia	Energy	3.3	N/A	0.2	3.1
Spark New Zealand	New Zealand	Telecommunications	3.3	N/A	0.1	3.2
Macquarie Korea Infra Fund	Korea	Fund	3.3	3.1	N/A	3.3
Vinacapital Vietnam Opps	Vietnam	Fund	3.0	2.9	N/A	3.0
Top 10 (% of holdings)			**45.9**	**17.4**		

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

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

	Portfolio end-March 2022	Portfolio end-March 2021	Change (pp)	Index weight	Active weight vs index (pp)
Australia	25.8	16.4	9.4	17.0	8.8
South Korea	16.0	15.5	0.5	11.9	4.1
Taiwan	13.8	11.0	2.8	15.3	(1.5)
China	13.6	27.8	14.2	28.4	(14.8)
Singapore	9.0	3.5	5.5	3.1	5.9
Hong Kong	5.5	10.2	(4.7)	6.0	(0.5)
India	3.6	0.0	3.6	12.4	(8.8)
Indonesia	3.4	4.5	(1.1)	1.7	1.7
New Zealand	3.3	1.8	1.5	0.4	2.9
Vietnam	3.0	2.9	(0.1)	0.0	3.0
Thailand	3.0	6.4	(3.4)	3.8	(0.8)
	100.0	**100.0**		**100.0**	

Source: HFEL, Edison Investment Research

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

	Portfolio end-March 2022	Portfolio end-March 2021	Change (pp)	Index weight	Active weight vs index (pp)
Financials	27.0	30.1	(3.1)	22.8	4.2
Communication services	19.1	13.7	5.4	8.7	10.4
Basic materials	13.1	13.1	0.0	9.0	4.1
Technology	12.2	15.7	3.5	20.8	(8.6)
Energy	10.6	3.2	7.4	3.5	7.1
Real estate	7.3	12.6	(5.3)	4.4	2.9
Industrials	6.3	2.7	3.6	6.2	0.1
Consumer discretionary	2.9	4.5	1.6	12.1	(9.2)
Utilities	1.5	0.0	1.5	2.7	(1.2)
Healthcare	0.0	0.0	0.0	5.1	(5.1)
Consumer staples	0.0	4.4	(4.4)	4.8	(4.8)
	100.0	**100.0**			

Source: HFEL

Performance: Ahead over 12 months

Exhibit 6: Share price and NAV total return performance, relative to indices (%)

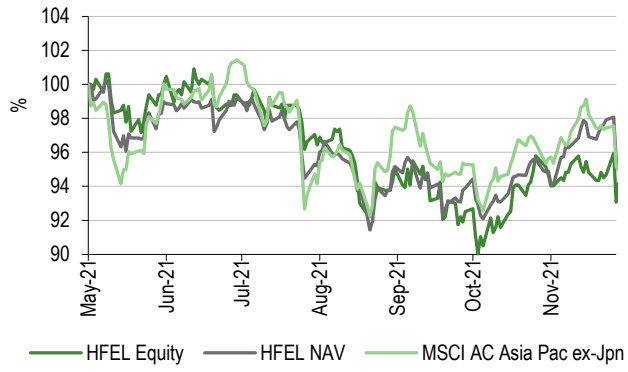
12 months ending	Total share price return	Total NAV return	MSCI AC Asia Pac ex-Jpn	MSCI AC Asia Pac ex-Jpn HDY	CBOE UK All Cos	MSCI AC World
30/04/18	8.5	8.8	13.0	12.2	8.1	7.8
30/04/19	4.6	4.6	3.0	4.4	2.5	11.6
30/04/20	(7.9)	(9.1)	(5.2)	(8.5)	(17.2)	(1.2)
30/04/21	12.4	16.2	35.7	17.0	25.3	33.4
30/04/22	(0.6)	(0.7)	(9.2)	3.3	9.1	4.7

Source: Refinitiv, Edison Investment Research. Note: All % on a total return basis in pounds sterling. Data to end-April 2022. Geometric calculation.

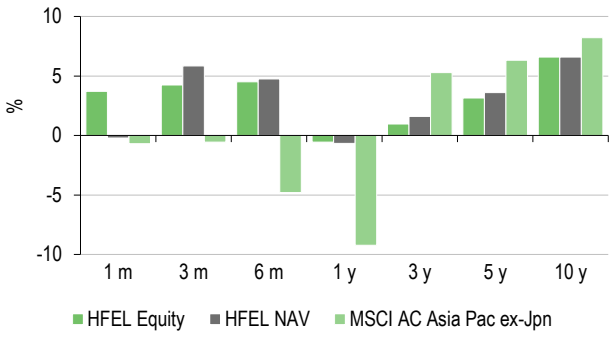
Performance of the portfolio through the COVID-19 crisis has been a little lacklustre. Companies that benefitted from trends that were accelerated by lockdowns, such as online transactions, were not well represented in the portfolio (as they tend not to pay dividends), which has negatively affected medium-term performance relative to the MSCI AC Asia Pacific ex-Japan index. These stylistic dynamics have been a headwind to returns, so the reversal seen over the last 6–12 months as rising interest rate expectations became priced into low-yielding growth stocks has been a fillip to performance. Likewise, the reduction in Chines stocks and a high Australian weighting was beneficial to relative returns. Stocks that tapped into these trends and did well included banks such as CTBC, United Overseas Bank and KB Financial, and the Australian oil and gas company Woodside Petroleum.

Exhibit 7: Investment trust performance to 11 April 2022

Price, NAV and index total return performance, one-year rebased



Price, NAV and index total return performance (%)



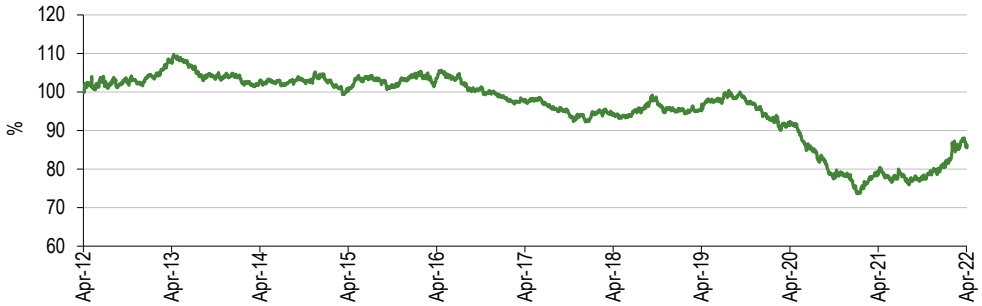
Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised.

Exhibit 8: Share price and NAV total return performance, relative to indices (%)

	1 month	3 months	6 months	1 year	3 years	5 years	10 years
Price relative to MSCI AC Asia Pac ex-Jpn	4.4	4.8	9.8	9.6	(11.9)	(14.0)	(14.0)
NAV relative to MSCI AC Asia Pac ex-Jpn	0.5	6.4	10.0	9.4	(10.1)	(12.2)	(14.1)
Price relative to MSCI AC Asia Pac ex-Jpn HDY	3.1	2.9	(2.1)	(3.8)	(7.0)	(9.8)	(5.8)
NAV relative to MSCI AC Asia Pac ex-Jpn HDY	(0.8)	4.5	(1.8)	(3.9)	(5.2)	(7.9)	(5.9)
Price relative to CBOE UK All Cos	3.5	2.7	0.8	(8.9)	(9.1)	(6.8)	(5.3)
NAV relative to CBOE UK All Cos	(0.4)	4.3	1.0	(9.0)	(7.4)	(4.8)	(5.4)
Price relative to MSCI AC World	7.4	6.4	8.1	(5.0)	(25.4)	(29.6)	(42.4)
NAV relative to MSCI AC World	3.4	8.0	8.3	(5.1)	(23.9)	(28.1)	(42.4)

Source: Refinitiv, Edison Investment Research. Note: Data to end-April 2022. Geometric calculation.

Exhibit 9: NAV performance versus index over 10 years



Source: Refinitiv, Edison Investment Research

Peer group comparison: Significant peer yield premium

HFEL is a significantly differentiated offering within the AIC Asia Pacific Equity Income peer group. The most obvious feature is a dividend yield of 7.9%, which compares to an average for the four other constituents of the AIC peer group of 4.5% and the index yield of 2.7%.

Exhibit 10: AIC peer group as at 6 May 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	452	0.1	5.3	18.7	89.1	1.09	No	0.11	102	7.9
abrdn Asian Income Fund	382	3.9	25.0	38.4	107.4	0.97	No	-12.60	110	4.2
Invesco Asia	225	-6.1	30.6	48.2	184.4	0.99	No	-11.59	100	4.6
JPMorgan Asia Growth & Income	356	-12.6	16.1	45.2	151.4	0.77	No	-11.76	99	5.3
Schroder Oriental Income	696	0.7	25.0	42.9	160.7	0.85	Yes	-6.99	104	4.0
Average (five funds)	422	-2.8	20.4	38.7	138.6	0.93		-8.57	103	5.2
HFEL rank in sector	2	3	5	5	5	5		1	4	1.0
MSCI AC Asia Pac Ex JPN		-9.1	15.2	32.8	113.5					2.7
MSCI AC Asia Pacific ex JPN HDY		7.0	14.3	28.1	93.0					5.6

Morningstar, Edison Investment Research. Note: *Performance as at 6 May 2022 based on cum-fair NAV. TR = total return. Net gearing is total assets less cash and equivalents as a percentage of net assets (100 = ungeared). % unless stated.

Compared with peers, HFEL is overweight at the country level to Australia, South Korea and New Zealand and underweight Taiwan, China, Hong Kong and India. At the sector level, the portfolio is overweight basic materials, energy and communication services and is underweight consumer, industrials and technology.

Exhibit 11: AIC peer group selected country and sector positioning

% unless stated	Australia	Korea	Taiwan	Hong Kong	China	Basic materials	Energy	Consumer	Tech
Henderson Far East Income	**25.6**	**16.0**	**13.8**	**5.5**	**13.6**	**13.1**	**10.6**	**2.9**	**12.2**
abrdn Asian Income Fund	16.8	9.2	18.5	5.6	7.8	9.7	0.0	11.0	26.1
Invesco Asia Trust	2.5	13.5	15.5	13.1	30.5	3.5	0.0	24.8	20.4
JPMorgan Asia Growth & Income	0.8	17.7	15.2	9.3	29.2	1.6	2.9	19.3	24.4
Schroder Oriental Income	18.0	13.1	24.1	12.5	10.0	11.5	1.0	4.1	29.5
Simple average (five funds)	**12.7**	**13.9**	**17.4**	**9.2**	**18.2**	**7.8**	**2.9**	**12.4**	**22.5**
HFEL rank in peer group	**1**	**2**	**5**	**5**	**3**	**1**	**1**	**5**	**5**
MSCI AC Asia Pac ex-Jpn	17.1	13.1	17.7	12.5	30.7	8.2	2.1	17.7	21.7
MSCI AC Asia Pac ex-Jpn HDY	27.4	6.5	20.1	8.6	21.3	21.1	2.4	12.4	17.0

Source: Morningstar, Edison Investment Research. Note: HFEL: AAIF: Feb 22; IAT: Feb 22; JAGI: Mar 22; SOI: Feb 22; BM: Mar 22.

Dividends: Strong recovery with more to follow

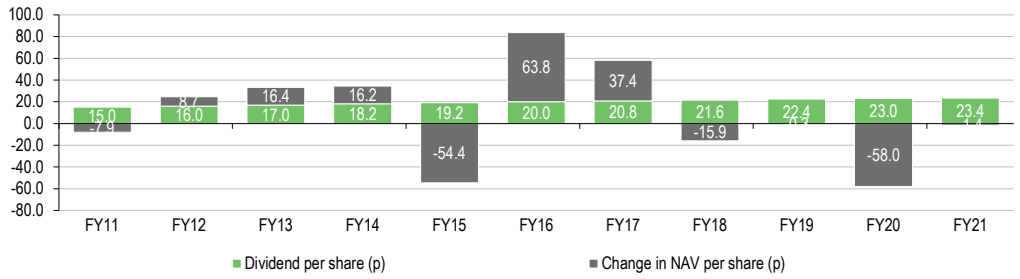
Since launch in 2006, HFEL has paid four dividends per year, in February, May, August and November. These have tended to be equally weighted and in H122 (to end-February) the trust paid dividends of 5.9p per share in November and February, which is a 1.7% increase on the 5.8p per share payments in November and February 2021. Underlying revenue derived from dividends paid by the portfolio companies has recovered strongly since 2020 as COVID-19 disruptions abate and companies feel more confident about their outlook and their ability to pay dividends. In H122, revenue from dividends increased 14.7% on the same period in 2021; however, total income growth was slightly lower at 11.9%, due to fewer options being written. Overall revenue per share increased by 15.3% as a result of additional contributions from lower tax and management charges.

Since launch in 2006 to the end of December 2021, HFEL's dividend has grown at a compound annual rate of 5.85% versus 3.4% for the MSCI AC Asia Pacific ex-Japan index and 1.3% for the UK's largest companies. The managers expect portfolio dividend growth to be significantly above the 5% forecast for the MSCI Asia Pacific ex-Japan index through 2022.

The case for Asian equity income funds

HFEL is able to draw revenues from a diverse set of geographic markets and industries. This provides the fund managers with layers of diversification, a benefit not available to purely country-specific income strategies. It is a key reason why investors should consider Asian income as a diversifier from other, more developed market, dividend-paying strategies. Although China provided a third of the trust's income in FY21, Australia, Taiwan, South Korea and Hong Kong accounted for a little over 50%, with the remainder spread around Thailand, India, Indonesia and Singapore. From a sector position, financials accounted for 40% of dividend revenue with basic materials, technology, communication services, industrials and real estate in aggregate delivering around half of HFEL's income. In the UK equity income sector, for example, the most popular sectors are financial services at around 20%, then consumer defensives, industrials, consumer cyclicals, telecommunications and healthcare. The correlation of returns between UK and Asian income strategies over 10 years is 0.65%, illustrating the diversification benefits of including a strategy such as HFEL in concert with a UK equity income fund, for example.

Exhibit 12: Dividend history since FY2011

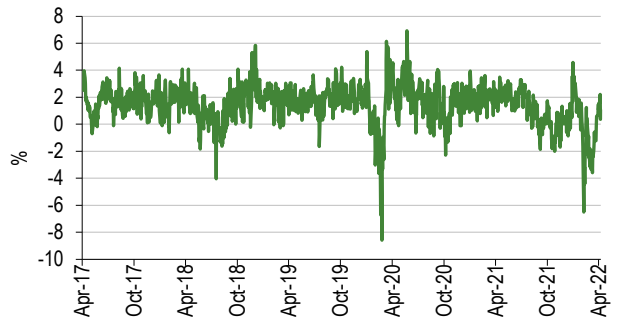


Source: Bloomberg, Edison Investment Research

Discount: Historically the tightest in the peer group

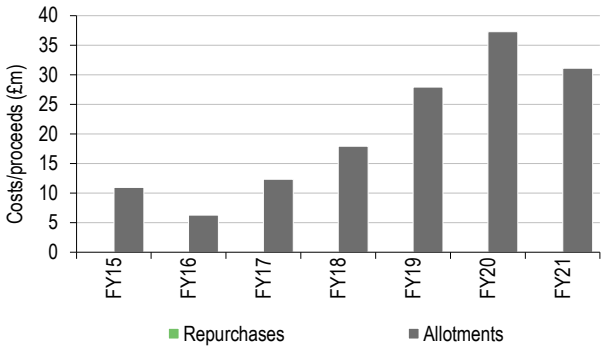
At 5 May 2022, HFEL's shares traded at a 0.1% premium to cum-income NAV compared with a 10-year cum-income average premium of 0.9%. HFEL has been notable in its ability to trade closer to NAV when compared to its AIC Asia Pacific Equity Income peer group, which, over the same period, has averaged a 5% discount. The board regularly issues new shares to meet demand and 475,000 share were in issued in H122 (H121: 9.6m, £9.1m) for a consideration of £1.4m. Investor demand continues to support income-generating assets.

Exhibit 13: Discount/premium over three years



Source: Refinitiv, Edison Investment Research

Exhibit 14: Buybacks and issuance



Source: Morningstar, Edison Investment Research

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 (net gearing of 2% at 19 April 2022); 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 HDY index.

Investment process: Undervalued reliable income

HFEL uses a consistent and disciplined approach to build a portfolio of c 40–60 stocks (March 2022: 45) 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 has managed this portfolio since 2007 and began managing Pacific equities on joining Henderson Global Investors (now Janus Henderson Investors) in 2004. 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.

Aside from disinvestment, one of the most powerful tools that the manager has is to vote against management. In FY21, HFEL's portfolio holdings held 55 AGMs across nine jurisdictions equating to 535 resolutions. On 5.4% (FY20: 3.5%) of the resolutions, HFEL's management voted against corporate management, with the majority being dissent against director independence.

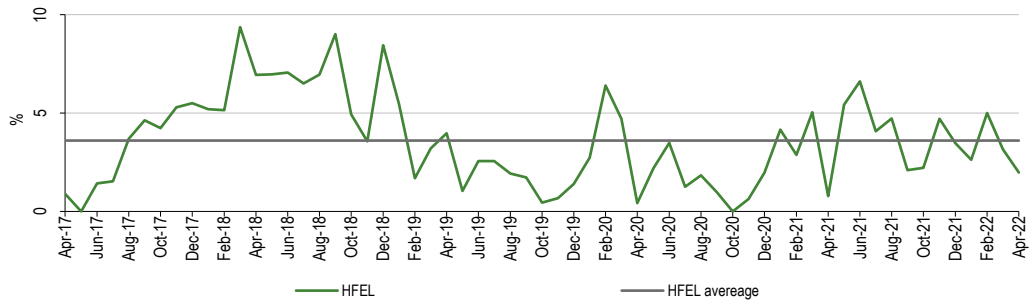
The managers do not exclude any sector from HFEL on ESG grounds, with the exception of munitions. They say that in order to reach the trust's long-term ESG goals, 'the transition is just as important as the destination. We want to invest in companies that are improving the environment in which we live, 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.

Gearing: Active use to assist income generation

HFEL is permitted to gear up to 30% of gross assets, which is arranged via a £50m multicurrency bank loan facility with SMBC Bank International that expires in August 2023. This facility, if fully drawn down, would only account for a maximum of around 10% of current (May 2022) gross assets. The current level of gearing is 2% (5 May 2022).

Exhibit 15: Active use of gearing



Source: Morningstar, Edison Investment Research

Fees and charges: A recent reduction in fees for investors

Since September 2021, the trust has paid its alternative investment manager, Janus Henderson Fund Management UK, a flat annual management fee of 0.75% on net assets, replacing the previous arrangements of 0.90% of net assets up to £400m and 0.75% thereafter, with no performance fee payable. Ongoing charges for FY21 were 1.09% (FY20: 1.08%). Management fees and other expenses are equally levied against capital and revenue.

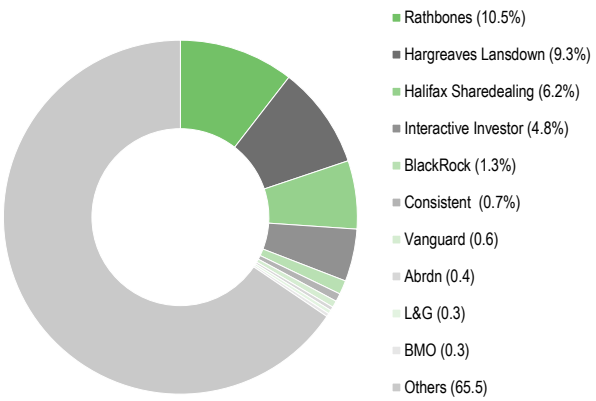
Capital structure: Slowing issuance

HFEL was set up as a London-listed but Jersey-based closed-end investment company in 2006, and while it retains its Jersey domicile, during FY19 it moved its tax residence to the UK and joined the investment trust regime.

The company, which has a single share class, has been active in issuing shares when able to do so and there were 151.7m ordinary shares in issue at 5 May 2022, an increase of 4.6m over the preceding 12 months (see Exhibit 14). Meeting investor demand with issuance can be helpful for reducing costs and increasing liquidity but it also means the manager needs to invest in attractive yield opportunities without delay to minimise the potential impact of income dilution.

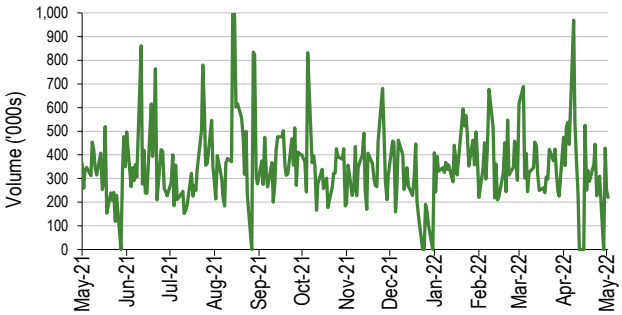
The average daily traded volume in HFEL's shares (Exhibit 17) was 369,000 shares over the 12 months to 11 April 2022, which represents a daily volume of around £1m for this £452m market cap company and a reasonable level of trading liquidity at approximately 0.2% of the share base per day. In Exhibit 16 we list the trust's largest 10 shareholders, with around 20% held via retail investor platforms (Hargreaves Lansdown, Halifax Sharedealing and Interactive Investor). This speaks to the attractiveness of the proposition for income seeking investors and can be considered a factor in keeping the discount narrower than peers.

Exhibit 16: Major shareholders



Source: Bloomberg, as at 1 March 2022.

Exhibit 17: Average daily volume



Source: Refinitiv. Note 12 months to 5 May 2022.

The board

Exhibit 18: Henderson Far East Income's board of directors

Board member	Date of appointment	Remuneration at FY21 end	Shareholdings at Apr 22
John Russell (chairman)	Nov 2006	39,000	70,306
Julia Chapman (SID)	Jan 2015	31,000	2,616
Timothy Clissold	Sep 2018	28,000	70,000
Nicholas George (audit chair)	Apr 2016	34,000	38,550
Ronald Gould (chair designate)	Oct 2021	N/A	27,324
David Mashiter	Nov 2006	31,000	5,000

Source: Henderson Far East Income

Chairman John Russell will be stepping down from the board after a handover to the chair designate Ronald Gould.

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