Henderson Far East Income

Finding high yields and dividend growth in Asia

Investment trusts
Asia-Pacific equity income

7 June 2019

Price	**349.0p**
	NZ$6.69
Market cap	**£448.8m**
Net assets	**£442.6m**

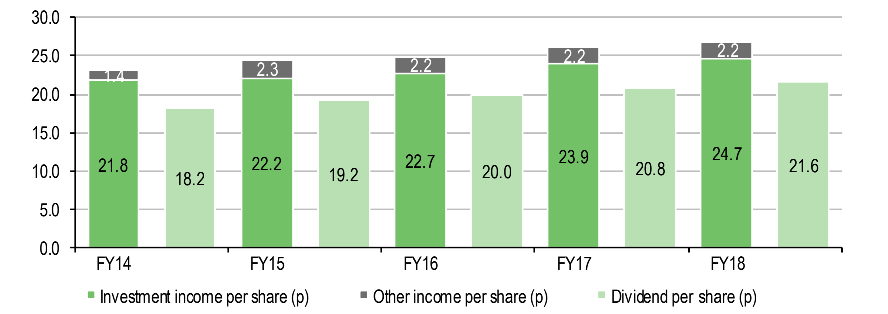
NAV*	342.6p
Premium to NAV	1.9%
NAV**	344.2p
Premium to NAV	1.4%

*Excluding income. **Including income. As at 5 June 2019.

Yield	6.3%
Ordinary shares in issue	128.6m
Code	HFEL
Primary exchange	LSE
AIC sector	Asia Pacific – Income

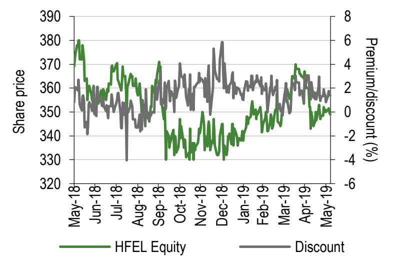
Henderson Far East Income (HFEL) continues to reward its investors with a c 6% dividend yield, fully covered by revenues and growing year-on-year (4.9% CAGR over five years), as well as capital growth (total returns of c 8–14% a year over three, five and 10 years). Manager Mike Kerley notes that payout ratios across the Asia-Pacific region are increasing, supported by the strong cash position of many companies, although at an index level it is hard to observe the improvement, because of the huge growth of non-yielding Chinese internet stocks. The manager holds a relatively concentrated (c 50 names) portfolio of stocks that are broadly evenly split between those with a high starting yield and those offering good dividend growth prospects, and are diversified by sector and geography.

HFEL pays well-covered dividends; revenues are supported by option-writing

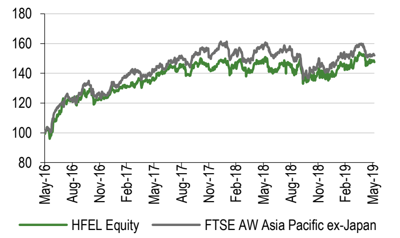


Source: Henderson Far East Income, Edison Investment Research. Note: Excludes expenses.

Share price/discount performance



Three-year performance vs index



52-week high/low	380.0p	330.0p
NAV* high/low	373.1p	322.9p

*Including income.

Gearing

Gross*	1.0%
Net*	1.0%

*As at 30 April 2019.

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

The market opportunity

Asian economies are growing at a faster pace than the developed world (International Monetary Fund figures suggest GDP growth of 6.3% in 2019 and 2020, compared with 1.8% and 1.7% respectively for advanced economies). As well as offering a low-cost manufacturing base, the region's increasing affluence is driving domestic consumption growth. Forward P/E valuations are at a 10% discount to the world market, although investors should be mindful of the potential impact of trade disputes.

Why consider investing in HFEL?

- Well-covered, consistently high yield.
- True income focus means portfolio may perform more defensively in volatile periods than a growth-focused fund paying dividends out of capital.
- Access to cash-generative companies in the world's fastest-growing economies.
- Income is well spread by geography and sector; HFEL is not a 'barbell' portfolio, although it is broadly evenly split between high yield and dividend growth.

High yield supports a consistent premium to NAV

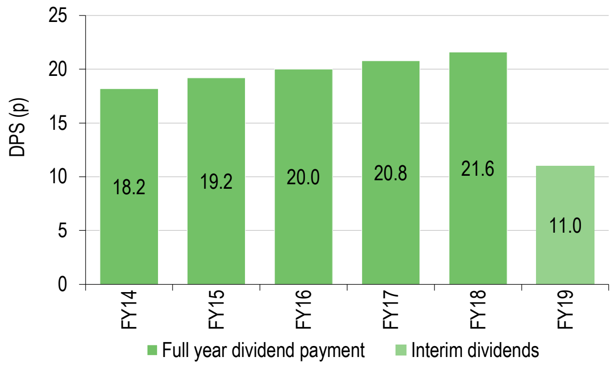
At 6 June 2019, HFEL's shares traded at a 1.4% premium to cum-income NAV. On average the shares have traded at a premium over one, three, five and 10 years. HFEL regularly issues shares to meet demand and control the premium, yet it has still consistently managed to cover its dividend, grow the distribution year-on-year, and transfer money into its revenue reserve, in spite of having to spread its income (current yield of 6.3%) over an ever-increasing share base.

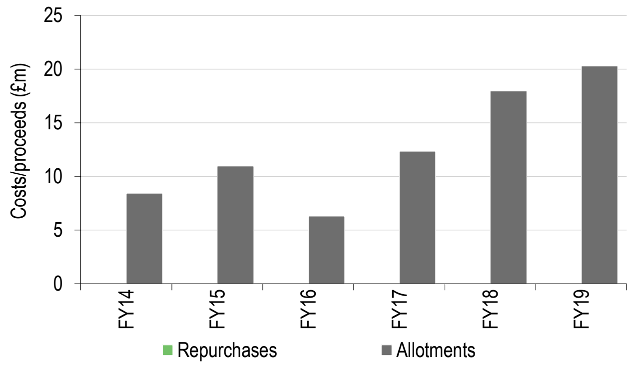
Exhibit 1: Trust at a glance

Investment objective and fund background	Recent developments
Henderson Far East Income aims to provide shareholders with a growing total annual dividend per share, as well as capital appreciation, from a diversified portfolio of investments in the Asia-Pacific region. The fund is classified by the AIC in the Asia Pacific – Income category and, while it does not have a benchmark, sees the FTSE Asia Pacific ex-Japan Index as the most appropriate comparator. While the fund may hold Japanese investments, these are not expected to be a substantial part of total assets.	■ 26 April 2019: Results for the half-year ended 28 February. NAV TR -3.5% and share price TR -0.8% versus -3.7% for the FTSE Asia Pacific ex-Japan Index. ■ 25 April 2019: Second interim dividend of 5.5p declared in respect of FY19. ■ 23 January 2019: First interim dividend of 5.5p declared in respect of FY19. ■ 2 November 2018: Annual results for the year ended 31 August. NAV TR +1.5% and share price TR -0.6%, versus +2.4% for the FTSE Asia Pacific ex-Japan Index.

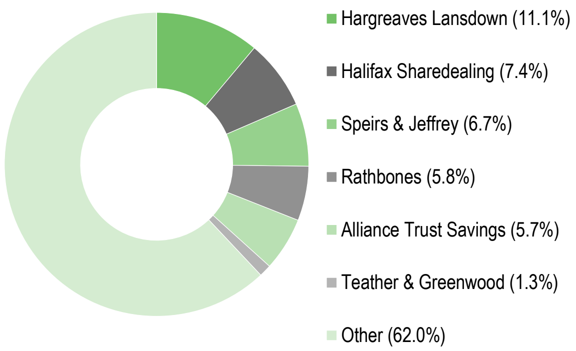
Forthcoming		Capital structure		Fund details	
AGM	January 2020	Ongoing charges	1.09%	Group	Janus Henderson Investors
Annual results	November 2019	Net gearing	1.0%	Manager	Michael Kerley
Year end	31 August	Annual mgmt fee	Tiered (see page 9)	Address	201 Bishopsgate,
Dividend paid	Feb, May, Aug, Nov	Performance fee	None		London, EC2M 3AE
Launch date	2006 (as a Jersey co)	Trust life	Indefinite	Phone	+44 (0) 7818 1818
Continuation vote	No	Loan facilities	£45m	Website	www.hendersonfareastincome.com

Dividend policy and history (financial years)	Share buyback policy and history (financial years)
Dividends are paid quarterly. The company aims to distribute substantially all its income (after costs) arising in each accounting period.	HFEL is authorised to repurchase up to 14.99% of its shares, to hold up to 10% of shares in treasury, and to issue up to 10% of shares each year.

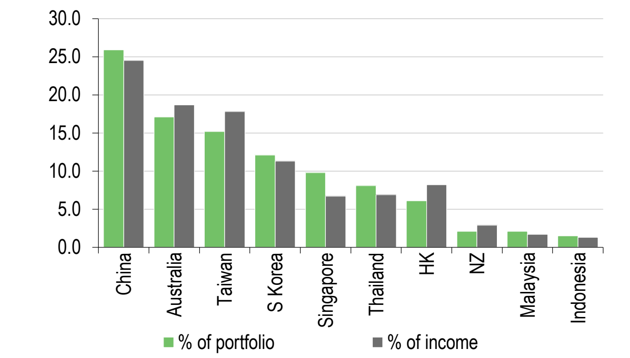




Shareholder base (as at 30 April 2019)



FY18 share of income vs share of portfolio (as at 31 August 2018)



Top 10 holdings (as at 30 April 2019)

			Portfolio weight %	
Company	**Country**	**Sector**	**30 April 2019**	**30 April 2018***
Macquarie Korea Infrastructure Fund	South Korea	Financials	3.1	2.6
HKT Trust & HKT	Hong Kong	Telecoms	3.0	N/A
China Construction Bank	China	Financials	3.0	3.8
Rio Tinto	Australia	Basic materials	2.8	N/A
Industrial & Commercial Bank of China	China	Financials	2.8	N/A
Treasury Wine Estates	Australia	Consumer goods	2.7	N/A
Taiwan Semiconductor Manufacturing	Taiwan	Technology	2.7	2.6
China Yangtze Power	China	Utilities	2.7	2.6
Digital Telecoms Infrastructure Fund	Thailand	Telecoms	2.5	N/A
Macquarie Group	Australia	Financials	2.5	2.7
Top 10 (% of holdings)			**27.8**	**28.4**

Source: Henderson Far East Income, Edison Investment Research, Bloomberg, Morningstar. Note: *N/A where not in end-April 2018 top 10.

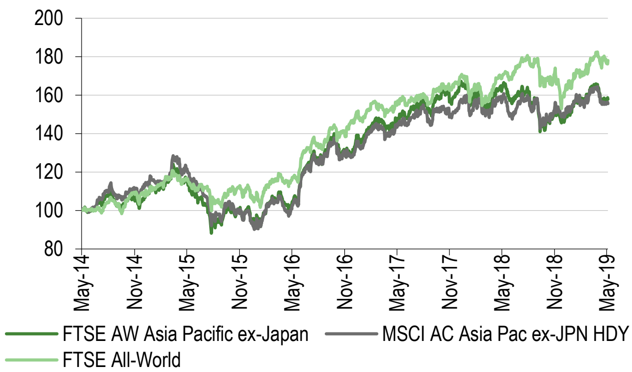
Market outlook: Reasons to be cheerful

Asia-Pacific equity markets have somewhat lagged the global index over the past five years (Exhibit 2, left-hand side), against a backdrop of strong returns from the dominant US, which accounts for c 60% of world market capitalisation. Nonetheless, absolute returns for sterling-based investors have been solid, both from the broad market (FTSE Asia Pacific ex-Japan) and the yield-focused MSCI AC Asia Pacific ex-Japan High Dividend Yield Index, both up more than 55% over the period. It is interesting to note that despite fears over the US-driven trade dispute with China, Asian markets sold off by less than the global aggregate in the sharp declines of December 2018. As HFEL Manager Mike Kerley notes (see The manager's view), the trade war is actually likely to hurt US consumers as much as Chinese exporters, while any manufacturing that moves away from China as a result of the dispute is still likely to remain in Asia.

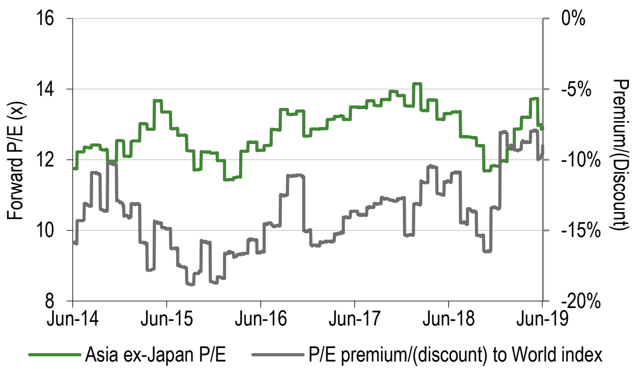
While the Q418 sell-off saw valuation multiples reach compelling lows, the rebound since has brought forward P/E multiples in Asia ex-Japan (based on Datastream indices) back in line with five-year average levels (right-hand chart). Asian equities tend to trade on a lower average P/E than the world average, in spite of the positive demographic and economic supports for faster growth in the region. The discount to the world index currently stands at 9.0% versus a five-year average of 13.9%. However, with a huge range of underlying companies in the Asian region, investors who look beyond the averages may still find compelling value, and rising dividends should form an important support to total returns if market volatility picks up again.

Exhibit 2: Market performance and valuation

Asia-Pacific and world equity index total returns, in sterling



Asia ex-Japan forward P/E and discount to World forward P/E



Source: Refinitiv, Edison Investment Research

Fund profile: High-yielding Asia-Pacific income fund

Henderson Far East Income (HFEL) has existed in its current form since 2006, when it was set up as a Jersey-incorporated successor vehicle to the onshore Henderson Far East Income Trust. At the time, the move to Jersey meant more favourable tax treatment of overseas dividends; however, since then, the UK has removed the requirement for investment trusts to pay tax on overseas dividends. The UK also has a greater number of double-taxation agreements with Asian nations than Jersey does, meaning HFEL would pay less withholding tax as a UK tax-resident company. As a result, the fund has recently relocated its tax residence to the UK and become an investment trust under the terms of the Companies Act 2006, although it remains a Jersey company. The trust's shares are listed in London and New Zealand, and in May 2019 it became a founding member of the Association of Investment Companies' new Asia Pacific – Income sector. HFEL does not have an official performance benchmark.

The trust's aim is to achieve a high and growing income, as well as capital growth, by investing across the Asia-Pacific region (including Australasia). As an Asia-Pacific equity fund, it is required to invest at least 80% of its assets in the shares of companies that are listed in, registered in, or whose principal business is in the region. HFEL may also hold debt securities, warrants, and equity-related securities, such as unlisted companies that are soon to debut on public markets, and the manager may write options as a way of generating additional income through premiums. Gearing is permitted up to 30% of gross assets, although was much lower than this, at 1.0%, on 30 April 2019.

The fund manager: Mike Kerley

The manager's view: Positive dividend growth trends in Asia

Kerley is encouraged by the continued development of a dividend culture in the Asia-Pacific region. He says that while historically, Asian companies may have seen the return of cash to shareholders as an admission that they had run out of ideas for growth, they are now beginning to understand that paying dividends can add value over time. This has gone hand-in-hand with a change in the mindset of the domestic investor base in the region, says the manager, with a greater number of long-term institutional investors (such as pension funds), and fewer 'get rich quick' day-traders. Kerley explains that dividend culture is most advanced in Australia, Hong Kong, Taiwan and Singapore, which have much higher payout ratios than the rest of the region, while the more notable dividend growth is coming from countries that have historically paid out less, such as China, South Korea, Thailand and Indonesia.

The increased payouts are supported by the fact that corporate cash levels in Asia are 'incredibly high', says Kerley, at around nine times the value of dividends paid, compared with three to four times in Europe and the US. The payout ratio for the Asia-Pacific region (which includes Australia and New Zealand) is c 50%, but for the Asian region (excluding Australasia) it is less than 35%. However, while rising payouts are evidenced by HFEL's H119 revenues being 16.5% higher year-on-year, Kerley says many investors may not realise that most companies are paying higher dividends, as at the index level, rising dividends from the majority of companies have been cancelled out by the huge growth of non-dividend paying stocks such as Tencent and Alibaba.

Away from the positive trend of dividend growth, Kerley says that probably the most prominent issue for investors in Asia is the trade dispute between the US and China. The manager believes that the longer it goes on, the less likely it is that there will be a solution. 'We can only get out of this if both President Xi and President Trump win, and we are running out of ways for them to do that,' he argues. However, Kerley says that contrary to US rhetoric, the trade war is actually less damaging to China. 'Chinese companies are not cutting prices; US consumers are the ones who will be paying more if tariffs are put on t-shirts, watches, shoes and the like,' says the manager.

He also notes that the worse the trade war gets, the more the Chinese government will do to stimulate the economy, in terms of fiscal policy, infrastructure spending and other measures. 'The good news is that China has lots of levers to pull, which the US doesn't,' he adds. However, he does have a note of caution regarding the banking system in China, as more stimulus may increase the risk of banks lending imprudently. 'In a huge state push, we would be worried about the banks (which we do own currently), but areas related to consumption would be the big beneficiary – property, consumer and other goods. If you want to be in China, that is where you have got to be,' says Kerley. He adds that he is considering reducing exposure to Chinese banks and adding to holdings in the property sector, where he currently owns one stock – China Vanke – which is highly profitable and has one of the highest 12-month forecast rates of dividend growth in the portfolio, at 22%. 'If the Chinese government wants to stimulate the economy, property is a great way to do that, and in order to do so, they would only need to take off some of the restrictions they put in a few years ago to stop the market overheating,' he concludes.

Asset allocation

Investment process: Seeking value, yield and dividend growth

HFEL uses a disciplined, consistent approach to build a relatively equal-weighted portfolio of 40–60 stocks from across the Asia-Pacific region (which may include Japan, although this is not likely to be to a significant degree). The management team seeks to achieve a good balance of high-yielding stocks and those offering superior dividend growth prospects, with the aim of providing an attractive total return, supported by a relatively high dividend yield. There is no official benchmark, and the only significant investment restriction is that no stock may make up more than 10% of the total portfolio. While the managers are cognisant of the impact of macroeconomic and geopolitical factors on companies in the region, portfolio construction is largely bottom-up. Lead Manager Mike Kerley is based in London (although he travels frequently to the Far East), supported by Sat Duhra and James Zhang Rui in Singapore.

Company meetings (conducted both in local markets and in London, which remains an important international financial hub) are a key source of new idea generation, as well as a way of keeping in touch with developments at portfolio holdings. The team also reads industry research (access to which is funded centrally by Janus Henderson Investors, which helps to keep costs down), and uses quantitative screens to identify companies with high yields and/or growing dividends. The managers seek cash-generative businesses with good growth prospects, trading at attractive valuations. There is a relatively even split between stocks offering a high starting yield, and those with the prospect of high dividend growth.

Exhibit 3: HFEL portfolio metrics versus indices at 30 April 2019 (% unless stated))

	HFEL	FTSE Asia Pacific ex-Japan	MSCI AC Asia Pac ex-Jp HDY
Price/book (x)	1.7	1.7	1.4
12m forward P/E (x)	12.6	13.6	10.4
Dividend yield	4.7	3.0	4.8
12m forward dividend yield	5.0	3.2	4.8
Free cash flow yield	6.9	6.8	7.3
Return on equity	17.3	15.7	15.3

Source: Henderson Far East Income, Edison Investment Research

As shown in Exhibit 3, HFEL's value discipline means its portfolio holdings tend to trade on lower average forward P/E and price/book multiples than the average for the broad FTSE Asia Pacific ex-Japan Index, while its dual yield and dividend growth focus means current and prospective dividend yields are higher than those of the index. The fact that HFEL's average valuation multiples are somewhat higher than those of the MSCI AC Asia Pacific ex-Japan High Dividend Yield Index, and its current yield marginally lower, may point to the presence of 'value traps', or stocks at risk of dividend cuts, in the high-yield index, which is a mechanically derived selection of the highest-yielding stocks in the region. It is worth noting that HFEL's option-writing strategy means its own yield is higher than that of its underlying portfolio. Call options are only written (or put options sold) based on prices at which the managers would be happy to sell or buy a stock.

All holdings are assigned a target price, and may be sold once this price is reached (even if the holding period has been relatively short). The portfolio is subject to ongoing monitoring against risk and style metrics and country and industry fundamentals; any deterioration in these may also trigger the sale of a position. Portfolio turnover was 92.4% in FY18, which was broadly in line with the average of the last five years (88.2%) and implies an average holding period of a little over a year, although many stocks have been in the portfolio for much longer.

Current portfolio positioning

At 30 April 2019, there were 49 stocks in HFEL's portfolio, broadly unchanged from 50 a year earlier. The top 10 holdings accounted for 27.8% of the portfolio, compared with 28.4% at 30 April

2018. In geographical terms (Exhibit 4), China remains the largest weighting, although it is now the biggest underweight versus the FTSE Asia Pacific ex-Japan Index. HFEL does not hold big Chinese internet stocks such as Tencent and Alibaba (the two largest constituents of the index), because they currently offer no prospect of paying dividends. Kerley notes that China is HFEL's biggest source of income as well as its largest geographical exposure (see Exhibit 1), with a broad spread of high-yield and dividend growth stocks in the portfolio. While the manager notes that it is hard for HFEL to access some areas of the Chinese market (for example, healthcare, education and many consumer staples stocks are very expensive), he holds a variety of 'aspirational' consumer discretionary stocks linked to the growth of the Chinese middle class. Additional exposure to Chinese growth comes through stocks listed in other countries, such as Australia's Treasury Wine Estates, and Taiwan Cement, which has the majority of its production capacity in Southern China. Outside China, the manager has recently increased exposure in South-East Asian countries such as Singapore, Thailand and Indonesia, and initiated a position in Vietnam (although he has no exposure to Malaysia or the Philippines), while the weighting in South Korea has fallen, principally as a result of a reduction in the holding in Samsung Electronics (previously the largest position). Kerley notes that the historical valuation differential between North and South-East Asia (whereby the North was cheaper) has diminished to a degree in recent years.

Exhibit 4: Portfolio geographic exposure vs FTSE Asia Pacific ex-Jp index (% unless stated)

	Portfolio end-April 2019	Portfolio end-April 2018	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
China	22.9	28.0	(5.1)	28.2	(5.3)	0.8
Australia	16.6	14.6	2.0	17.3	(0.7)	1.0
Singapore	13.2	10.7	2.5	3.5	9.8	3.8
Taiwan	10.8	8.4	2.4	10.5	0.3	1.0
South Korea	10.5	15.4	(4.9)	11.6	(1.1)	0.9
Thailand	7.7	8.4	(0.7)	2.9	4.8	2.7
Hong Kong	7.3	5.6	1.7	10.4	(3.1)	0.7
Indonesia	4.6	2.0	2.6	1.9	2.7	2.4
United Kingdom	2.8	2.4	0.4	0.0	2.8	N/A
New Zealand	2.0	N/S	N/A	0.7	1.3	2.8
Other	1.6	4.5	(2.9)	13.0	(11.4)	0.1
	100	**100**		**100**		

Source: Henderson Far East Income, Edison Investment Research

In sector terms (Exhibit 5), the allocation to financials remains high, but has fallen back somewhat over the past 12 months. However, the underlying exposure is underweight banks (which face challenges because of the continued low interest rate environment), and overweight real estate. Exposure to Australian commercial banks is particularly low. Compared with the FTSE Asia Pacific ex-Japan Index, HFEL is most overweight telecoms (a good source of yield, and with defensive characteristics in the event of a market decline), and most underweight technology (as noted above, many of the largest technology stocks pay no dividends).

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

	Portfolio end-April 2019	Portfolio end-April 2018	Change (pp)	Index weight	Active weight vs index (pp)	Trust weight/ index weight (x)
Financials	37.0	42.7	(5.7)	32.4	4.6	1.1
Consumer goods	12.5	10.2	2.3	8.1	4.4	1.5
Telecommunications	10.8	7.7	3.1	3.2	7.7	3.4
Technology	8.6	11.2	(2.6)	18.5	(9.9)	0.5
Industrials	7.9	8.3	(0.4)	9.6	(1.7)	0.8
Basic materials	6.3	4.3	2.0	6.2	0.1	1.0
Consumer services	6.3	0.0	6.3	10.4	(4.1)	0.6
Oil & gas	5.8	13.8	(8.0)	4.9	0.9	1.2
Utilities	4.8	1.8	3.0	2.9	1.9	1.6
Healthcare	0.0	0.0	0.0	3.9	(3.9)	0.0
	100.0	**100.0**		**100.0**		

Source: Henderson Far East Income, Edison Investment Research

Recent purchases for the HFEL portfolio include Kweichow Moutai (the world's largest distillery company, purchased in late 2018 after the shares sold off), VinaCapital Vietnam Opportunity Fund (a diversified fund investing in state-run and private Vietnamese companies, both before and after listing), Treasury Wine Estates (like Kweichow Moutai, bought on share price weakness in late 2018), and the Indonesian Bank Negara, which has attractive small business lending and consumer/mortgage exposure. Sales include Public Bank in Malaysia (the manager felt there were better opportunities elsewhere), Zhengzhou Yutong Bus (Kerley believes it will eventually prevail in the consolidation of the Chinese electric bus market, but a cut in government subsidies makes it unattractive in the short term), and Thailand's Star Petroleum, although the manager notes he still favours refining (a focus for Star) over more diversified oil and gas stocks.

Performance: Strong record of absolute returns

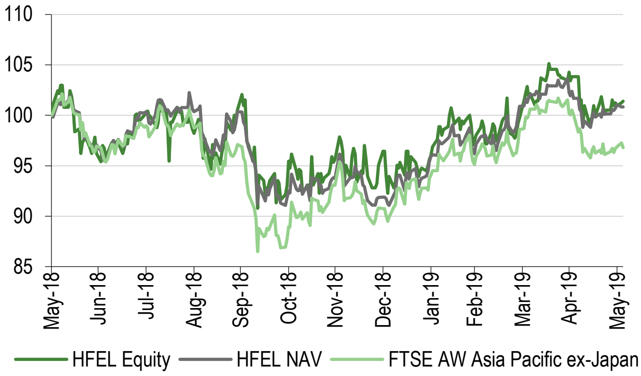
Exhibit 6: Five-year discrete performance data

12 months ending	Share price (%)	NAV (%)	FTSE AW Asia Pacific ex-Japan (%)	MSCI AC Asia Pac ex-Jp HDY (%)	FTSE All-Share (%)
31/05/15	13.9	16.4	16.3	21.1	7.5
31/05/16	(11.2)	(9.7)	(10.9)	(16.2)	(6.3)
31/05/17	35.3	32.5	41.2	41.0	24.5
31/05/18	8.4	7.7	11.5	9.5	6.5
31/05/19	1.0	1.1	(3.1)	(0.6)	(3.2)

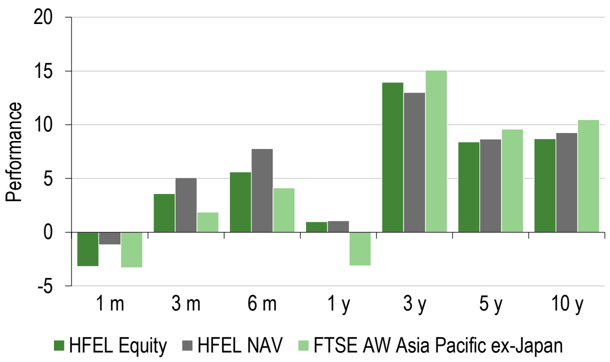
Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

Exhibit 7: Investment company performance to 31 May 2019

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.

HFEL has a solid record of generating absolute returns, with annualised share price and NAV total returns of c 9% over five and 10 years, and c 13-14% over three years (Exhibit 7). It has tended to lag its reference index (FTSE Asia Pacific ex-Japan) somewhat over most periods, given the more defensive (lower-risk/lower-return) nature of income stocks, and also the strong performance of technology stocks (now 18.5% of the index), which are less likely to pay attractive dividends. However, over one, three and six months and one year to 31 May 2019, HFEL has beaten the index in both share price and NAV total return terms (Exhibit 8). Surprisingly, this was not wholly attributable to the more defensive characteristics of an income-focused portfolio during periods of market volatility. Kerley notes that the portfolio actually performed better versus the index in the early 2019 recovery than it did in the late 2018 sell-off. The underperformance in Q418 was largely a result of HFEL's exposure to high-yielding stocks and China, both of which suffered from a thematic perspective. Rising bond yields in the US made equity income globally less attractive from a risk/reward perspective, and worries over the impact of the US-China trade dispute further weighed on investor sentiment. However, both of these pressures receded in the first part of 2019, as presidents Xi and Trump appeared (albeit briefly) to reach a truce, and the US Federal Reserve called a halt to its cycle of interest rate rises, amid fears over a slowdown in the economy.

Specific contributors to portfolio performance in the 12 months to 31 May 2019 included strong performance from Australia-listed mining stocks Rio Tinto and BHP Group, as well as Chinese consumer stocks Anta Sports and Kweichow Moutai (which was in the top 10 stocks as recently as March because of very strong performance, but has since been trimmed), which benefited from an uptick in Chinese consumption data. Strong performance also came from income-focused stocks including telecom-related companies HKT Trust & HKT and Digital Telecomnunications Infrastructure Fund, and real estate/infrastructure specialists Macquarie Korea Infrastructure, Mapletree North Asia Commercial Trust and Mapletree Commercial Trust. HFEL's portfolio saw very good income returns over the period, with a large number of special dividends (which Kerley sees as likely to be repeated, albeit not on the same scale as in H119) reflecting excess cash on company balance sheets. Detractors from performance during the period included oil companies and those in the automotive sector, such as Brilliance China Automotive (whose stake in a joint venture with BMW was reduced by the German carmaker buying a bigger share), and Zhengzhou Yutong Bus, which suffered because of higher-than-expected cuts to government subsidies on electric bus production.

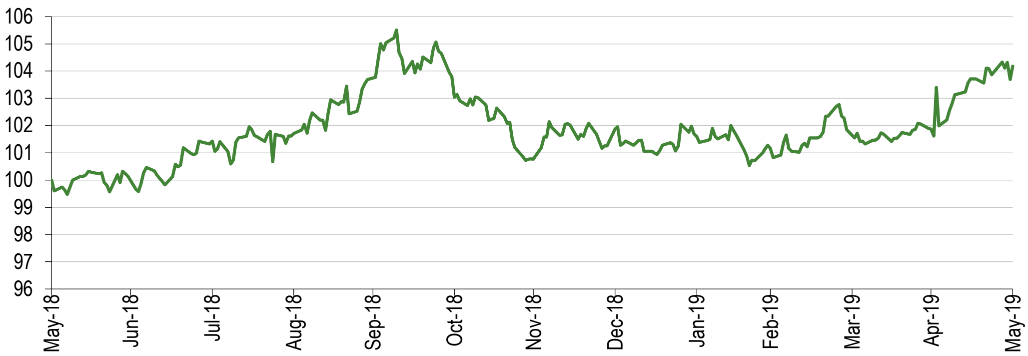
As shown in Exhibit 9, HFEL has outperformed the yield-focused MSCI Asia Pacific ex-Japan High Dividend Yield Index over the past year, with most of the excess return coming in the early and late parts of the period, rather than during the Q418 sell-off. Compared with this index, HFEL is very underweight Hong Kong and Taiwan, moderately overweight Australia and Singapore, and broadly in line in China. On a sector basis, HFEL is meaningfully overweight consumer stocks, industrials and telecommunications, and underweight financials (although overweight real estate), materials, oil & gas and utilities. Its technology weighting is broadly in line with the high-yield index.

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

	One month	Three months	Six months	One year	Three years	Five years	10 years
Price relative to FTSE Asia Pacific ex-Japan	0.1	1.7	1.4	4.2	(2.9)	(5.2)	(15.0)
NAV relative to FTSE Asia Pacific ex-Japan	2.2	3.1	3.5	4.3	(5.4)	(4.1)	(10.6)
Price relative to MSCI AC Asia Pac ex-Jp HDY	0.9	2.7	3.0	1.6	(3.6)	(4.0)	(15.1)
NAV relative to MSCI AC Asia Pac ex-Jp HDY	3.0	4.2	5.2	1.7	(6.0)	(2.8)	(10.6)
Price relative to FTSE All-Share	(0.2)	1.3	0.7	4.3	15.2	15.8	(7.6)
NAV relative to FTSE All-Share	1.9	2.7	2.8	4.4	12.3	17.2	(2.8)

Source: Refinitiv, Edison Investment Research. Note: Data to end-May 2019. Geometric calculation.

Exhibit 9: NAV TR performance relative to MSCI Asia Pacific ex-Japan HDY over one year

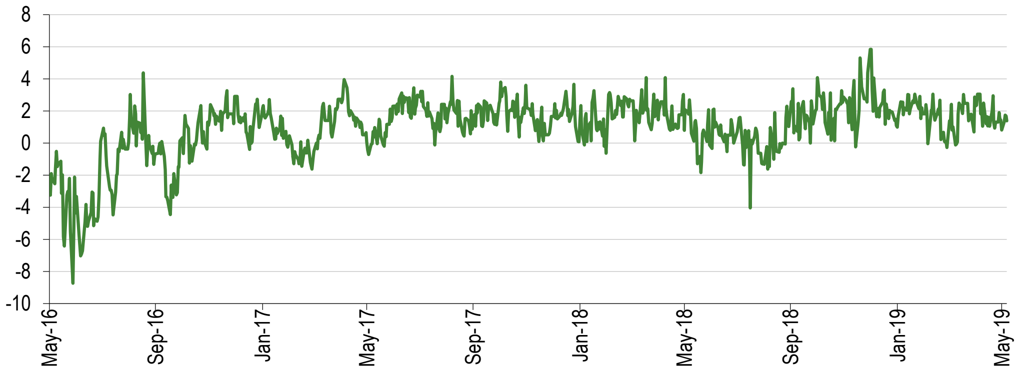


Source: Refinitiv, Edison Investment Research

Discount: High yield supports small premium to NAV

At 6 June 2019, HFEL's shares traded at a 1.4% premium to NAV. This is in line with the average premium over one year, and higher than the averages of 1.0%, 0.8% and 1.1% over three, five and 10 years, respectively. The premium reached a five-year high of 5.8% on 31 December 2018, during a month of market volatility that saw the trust's NAV fall slightly while its share price remained broadly steady. Regular share issuance helps to keep the premium in check, with strong demand for the shares likely reflecting the well-covered high yield.

Exhibit 10: Share price premium/discount to NAV (including income) over three years (%)



Source: Refinitiv, Edison Investment Research

Capital structure and fees

HFEL was set up in 2006 as a Jersey-registered, closed-end investment company. While it remains incorporated in Jersey, in the early part of FY19 it received approval to move its tax residency to the UK and become an investment trust. The move was made in order to access lower rates of withholding tax on some overseas investments, owing to the UK's greater number of double taxation agreements with other jurisdictions. HFEL has one class of share, with 128.6m ordinary shares in issue. New shares are regularly allotted to manage the premium to NAV, and so far in FY19, an additional 5.9m shares have been issued (an increase in the share base of 4.8%), raising £20.3m. This is a higher level of issuance in the first nine months of the year than the whole of FY18.

Gearing is permitted up to 30% of gross assets, although in practice it has tended to be much lower than this. During FY18, HFEL replaced its £35m borrowing facility with a new two-year, £45m multicurrency facility with Sumitomo Mitsui Bank. This equates to maximum available gearing of c 10% based on 22 May 2019 net assets. At 30 April 2019, HFEL's net gearing was 1%, having ranged between zero and 5% over the previous 12 months.

Henderson Investment Funds acts as HFEL's Alternative Investment Fund Manager (AIFM) under the AIFM Directive, and is paid an annual management fee of 0.90% of net assets up to £400m, and 0.75% thereafter. The new fee tier was introduced at the start of FY18, leading to a slight reduction in ongoing charges to 1.09% for the year, compared with 1.12% in FY17. There is no performance fee.

Dividend policy and record

Dividends are paid quarterly, in February, May, August and November, and have increased every year since HFEL's launch. For FY18, total dividends amounted to 21.6p, up 3.8% on the previous year, and the board has stated its intention to pay a dividend of at least this level for FY19. Dividends have been fully covered by income in each year of HFEL's operation, and the fund has often transferred some of its income into reserves, in order to support the record of dividend growth should portfolio income dip in future years. The move back to the UK for tax purposes is expected to give rise to a withholding tax saving of c £700,000 a year, which will support HFEL's ability to maintain its reserves against a backdrop of continued share issuance. At end-H119 (28 February), the revenue reserve stood at 14.4p per share, or two-thirds of the FY18 dividend. The manager may write options over selected holdings in order to generate premium income, providing a further support to the revenue stream. In FY18, option-writing supplied c 8% of HFEL's total income. So far in FY19, two quarterly dividends of 5.5p each have been declared, suggesting a minimum total dividend for the year of 22.0p (a 1.9% increase over FY18). However, in previous years the dividend has been increased at the third interim stage; if HFEL were to follow the pattern set since FY15, with the third quarterly dividend rising by 0.2p, the FY19 total dividend would amount to 22.4p, an increase of 3.7%. HFEL's dividend has grown at a compound annual rate of 4.9% over the last five years, well ahead of the rate of UK inflation. Based on the current share price and the last four dividends, HFEL has a yield of 6.3%.

Peer group comparison

HFEL is a member of the Association of Investment Companies' new Asia Pacific – Income sector, created in May 2019 as a result of the AIC's comprehensive sector review. It was previously in the Asia Pacific – excluding Japan sector, which has been renamed Asia Pacific. (While the fund does not specifically exclude investment in Japan, it is not expected to feature in the portfolio to any significant extent.) HFEL is one of a small number of funds launched in the mid-2000s with the specific objective of investing for income as well as growth. The others are Aberdeen Asian Income Fund and Schroder Oriental Income; while JPMorgan Asian and Martin Currie Asia Unconstrained also offer a high dividend yield, they achieve this mainly through a partial return of capital. Although HFEL's NAV total return performance has been below the average for this group over three, five and 10 years, it has consistently rewarded its shareholders with the highest dividend yield in the sector, paid quarterly and fully covered by income. HFEL's NAV total return is the highest in the sector over the past year, suggesting it (along with the other explicitly income-focused funds, which have produced smaller positive returns) has afforded investors a degree of protection from the market volatility seen recently as well as in the last quarter of 2018. Ongoing charges are a little above average for the group, but there is no performance fee. Gearing is below average, having ranged up to c 5% over the past year. HFEL consistently trades at a premium to NAV, and is currently the only trust in the peer group to do so. At 6.3%, its dividend yield is 1.8pp higher than its nearest rival.

Exhibit 11: AIC Asia Pacific – Income sector as at 22 May 2019*

% 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	**450.8**	**1.1**	**42.9**	**49.7**	**141.0**	**1.09**	**No**	**1.5**	**101**	**6.3**
Aberdeen Asian Income	361.6	0.7	44.7	41.5	205.1	1.11	No	(9.5)	109	4.5
JPMorgan Asian	327.9	(3.7)	73.9	89.5	158.8	0.75	No	(9.3)	100	4.5
Martin Currie Asia Unconstrained	142.8	(1.7)	49.4	54.9	119.9	1.07	No	(6.7)	100	4.1
Schroder Oriental Income	642.1	0.3	46.7	63.7	283.7	0.84	Yes	(0.7)	106	4.0
Sector average (5 funds)	**385.0**	**(0.7)**	**51.5**	**59.8**	**181.7**	**0.97**		**(4.9)**	**103**	**4.7**
HFEL rank in sector	**2**	**1**	**5**	**4**	**4**	**2**		**1**	**3**	**1**

Source: Morningstar, Edison Investment Research. Note: *Performance to 21 May 2019 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).

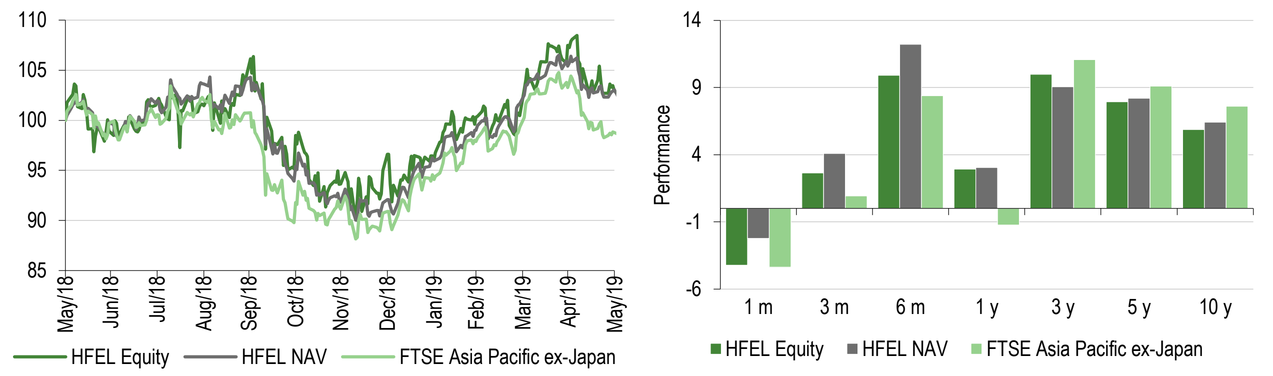
The board

There are five directors on HFEL's board, all non-executive and independent of the manager. The chairman, John Russell, has been in post since the fund's launch in 2006, and was also a director of its predecessor, Henderson Far East Income Trust. Nicholas George joined the board in 2016 and was appointed chairman of the audit committee following the retirement of David Staples at the 2018 AGM. David Mashiter has served as a director since launch, while Julia Chapman was appointed in 2015. Both are resident in Jersey. The newest director, Tim Clissold, joined the board in September 2018. The directors have professional backgrounds in investment banking, fund management and fund administration, and several of them have lived and worked in the Asia-Pacific region.

Performance tables in New Zealand dollar terms

Exhibit 12: Investment company performance – in New Zealand dollar terms to 31 May 2019

Price, NAV and benchmark total return performance, one-year rebased | Price, NAV and benchmark total return performance (%)



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

Although the exchange rate between the New Zealand dollar and the pound sterling was relatively unchanged from 31 May 2018 to 31 May 2019 (meaning HFEL's New Zealand-based shareholders received quite similar returns over one year to those in the UK), within the year the NZ dollar strengthened markedly versus the pound over the first half, before weakening again in the second half. This has boosted NZ dollar returns over the shorter periods of one, three and six months. Over the longer term, however, sterling weakness has dampened HFEL's returns for NZ dollar-based shareholders, with annualised share price and NAV total returns in NZ dollars of c 6–10% over three, five and 10 years, compared with c 8–14% for sterling-based investors.

Exhibit 13: Investment company discrete years' performance – in New Zealand dollar terms

12 months ending	Share price (%)	NAV (%)	FTSE Asia Pacific ex-Japan (%)	MSCI Asia Pacific ex-Japan HDY (%)	FTSE All-Share (%)
31/05/15	23.6	26.3	26.2	31.5	16.7
31/05/16	(10.9)	(9.5)	(10.6)	(15.9)	(6.0)
31/05/17	14.4	12.1	19.4	19.2	5.3
31/05/18	13.0	12.3	16.2	14.2	11.1
31/05/19	2.9	3.1	(1.2)	1.3	(1.3)

Source: Thomson Datastream. Note: Total return basis, in NZ$ terms.

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