



Murray Income



MUT has an attractive dividend yield and exposure to UK growth opportunities...

Summary

Update
07 December 2021

Murray Income Trust (MUT), managed by Charles Luke and Iain Pyle at abrdn, looks to invest across a broad range of companies to achieve a high and growing income combined with capital growth.

The trust is conservatively managed, so Charles and Iain aim to have a sensibly diversified portfolio. They ensure that the portfolio is not overly exposed to one economic scenario and therefore like to invest in a broad range of companies. Capital and income exposure to any one company is capped at around 5% of the portfolio. Additionally, Charles and Iain look for strong ESG characteristics which the experienced team at abrdn provide support in identifying.

At a current 6.8% discount, the share price rating has widened from a short lived 2.5% premium one year ago. The trust has delivered 48 consecutive years of dividend growth, notably maintaining the dividend during the COVID-pandemic. At the time of writing the dividend yield is 3.9% (02/12/2021).

Primarily, holdings are listed on the UK market, but the trust can invest up to 20% of the portfolio overseas. This allows for diversification of risk and allows access to companies and themes outside the UK market. Charles and Iain believe this allows them to maintain the quality of the portfolio despite its income mandate, as we discuss in the **Portfolio section**.

In November 2020, the trust merged with **Perpetual Income and Growth Investment Trust (PLI)** which has led to gross assets rising to over £1bn. Charles tells us that absorbing the extra assets was seamless and post the merger, MUT is cheaper in terms of OCF and bid/offer spread, to the benefit of shareholders.

Analyst's View

For income-seekers, MUT offers a dependable and stable source of income generation. MUT's 'Dependable, Diversified and Differentiated' investment approach has yielded strong and consistent income production. Not only has MUT consistently increased income production for the last 48 years, but crucially it has been able to maintain this strong income generation during the market turmoil of 2020. Key to this stability has been the focus on quality companies, in addition to the diversification which arises from having up to 20% of the portfolio invested outside of the UK.

ESG considerations are incorporated into the investment process behind MUT, and the team make use of the experienced ESG team at abrdn who often aid with stewardship and engagement matters. This has likely helped to contribute to the trust's AAA MSCI ESG rating. With a patient buy and hold approach, Charles and Iain do not trade opportunistically, but instead take a long-term view and allow the fundamental factors – including ESG factors – behind each investment to drive returns.

MUT is attractive given the exposure it gives to a diversified portfolio of high-quality companies, in addition to robust mid-sized companies which have greatly benefitted from the latest economic recovery. We think MUT could be appealing for ESG conscious investors seeking resilient levels of income generation especially during market stress, which is an atypical feature of many income generating investment trusts in addition to a focus on quality investing.

Analysts:

Neema Nabavian



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BULL

Murray Income Trust has delivered 48 consecutive years of dividend growth

Focus on quality companies has maintained income generation and good risk adjusted returns during market turmoil

Current discount of nearly 8% may offer an attractive point of entry

BEAR

Low exposure to the financial and energy sectors may mean trust struggles in a 'value' rally

Increase in gearing on the back of the merger could present risks if the market suffers a correction

No inflation related target for dividend growth



Portfolio

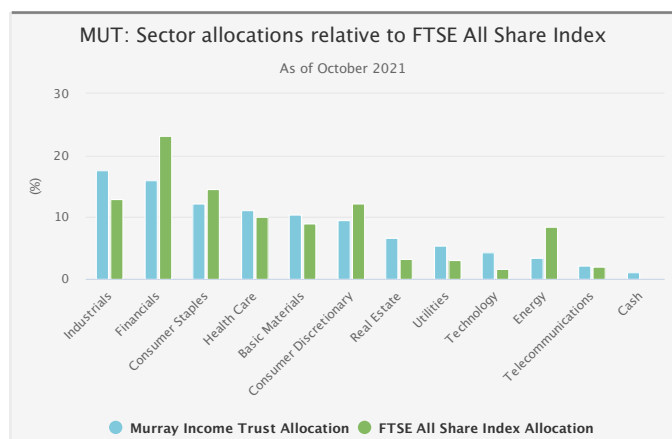
MUT invests in companies seeking to achieve a high and growing income coupled with capital growth through investments in a portfolio of predominately UK equities. MUT has net assets of c. £1.15bn invested across 61 holdings (as at 31/10/2021). A key focus of the trust is capital preservation, with the aim to provide a resilient performance during down markets. Like many of the investment strategies at abrdn, the emphasis is on investing in quality companies.

The managers define the three key metrics which differentiates MUT from its peers. Namely, these are Dependable, Diversified, and Differentiated. The investment process follows a tried and tested methodology that abrdn has used for years. In addition, they make use of proprietary research which allows for fundamental analysis. Under the Dependable metric, abrdn discusses the importance of a patient buy and hold approach which allows for the fundamentals of a holding to win through over time.

In terms of diversification, Charles and Iain look to diversify by income and capital per holding. They aim for the portfolio to include the best companies in any sector, although the team are not bound by the weightings of any sectors in the benchmark index. Capital and income exposure to any one company is capped at around 5% of the portfolio. The trust has the capability to invest up to 20% of assets in companies outside the UK. From a sector perspective, MUT invests broadly.

Compared to the FTSE All Share Index, MUT is notably underweight across the financial and energy sectors which have performed extremely well over the last year's economic recovery. Furthermore, MUT is underweight consumer staples and consumer discretionary sectors, but overweight industrials, healthcare, real estate, utilities, and technology sectors. Investors in MUT should note that

Fig.1: Sector Allocations



Source: abrdn, as at October 2021

during portfolio construction, a key focus is placed on the quality metric of an underlying holding and the managers do not follow the weightings of the index.

Charles and Iain look to deploy a Differentiated investment approach. Namely, one way is using the option writing program which Charles and Iain use to boost the income on their portfolio. This contributes to a steadier and more consistent earnings stream, as we discuss under **Dividend**.

The portfolio is predominantly comprised of large cap companies at 62% of the holdings, with mid-caps representing 36% and small caps representing 2% as at October 2021. The significant exposure to mid-caps, as well as the option of having up to 20% of the portfolio invested overseas, boosts the portfolio's diversification. Currently the trust is only c. 12.6% invested outwith the UK, across ten individual holdings.

Key to the long-term success of holdings within the portfolio has been the quality element. One proxy used by Charles and Iain as a measurement of quality across long term holdings has been the return on invested capital (ROIC). Defining the impact of macro factors such as growth, currencies and inflation can be challenging as a measurement of performance, however most long-term holdings held within MUT have maintained ROICs above the cost of capital, highlighting a sustainable competitive advantage.

An example of the quality investment approach taken by Charles and Iain includes holdings across TotalEnergies and BP. Whilst many investors could question the suitability of these holdings from an environmental perspective, Charles and Iain see both holdings as high quality, based on their energy transition credentials. The explanation of the proposed transition towards cleaner sources of energy production by the two companies was deemed to be highly transparent. Charles and Iain believe in the importance of active engagement and ownership with such companies. MUT does not own Royal Dutch Shell, with Charles explaining that he did not feel Shell were clear with their energy transition goals; hence the decision to omit any holdings.

According to Morningstar as at 02/12/2021, MUT is more concentrated than peers in the UK Equity Income sector, with 61 equity holdings versus the peer group's average of 604 holdings. As might be expected for an income strategy, from an equity style perspective, MUT has a higher exposure to value than the benchmark, with 29.4% versus the FTSE All Share 26.2%. MUT's exposure to core holdings at 56.7% compares to 51.8% for the benchmark, and growth exposure at 14.1% compares to the benchmark's 17.3%.

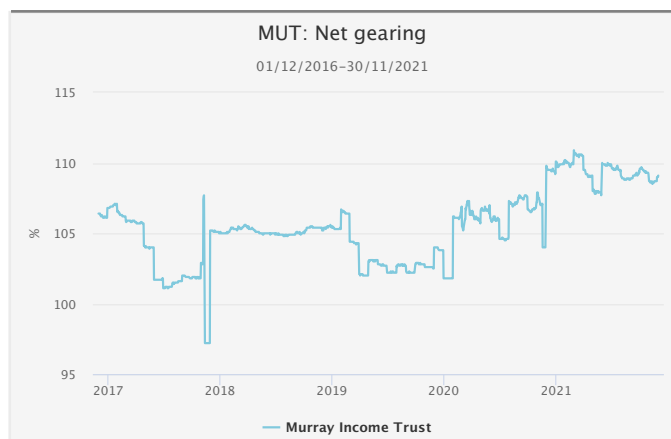


Gearing

Historically, MUT has been consistently geared, as the graph below illustrates. As at 30/11/2021, net gearing was at 9.1%. The trust has £100m of long-term borrowings with repayments of £40m and £60m due in 2027 and 2029 respectively, with an average interest cost of 3.6% per annum. The structural element of borrowings equates to c. 9.0% of NAV as of 02/12/2021, with the balance consisting of shorter-term flexible debt at a maximum of £20m currently. The trust’s long-term borrowing facilities were inherited from the merger with PLI, and as a result the subsequent merged entity has a higher gearing rate.

The gearing policy is set by the board. However, the manager is then permitted to set gearing levels within the agreed limits set by the board. The maximum level of gearing set by the board is 25% of NAV at the time of drawdown, with the board believing the appropriate neutral gearing rate is 10%. In the months leading up to the pandemic, MUT’s gearing rate was c. 1.8%; lower than the simple average five-year figure of c. 5.5%.

Fig.2: Net Gearing



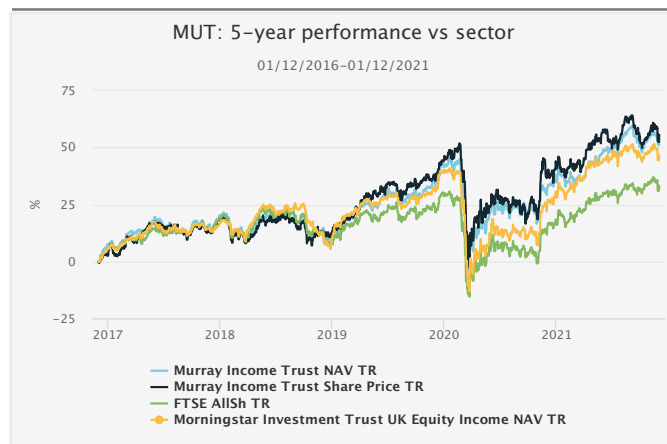
Source: Morningstar

Performance

Objectively, MUT aims to achieve a high and growing income combined with capital growth. MUT’s dividend has grown in the past 48 years consecutively. However, where the trust has further succeeded is satisfying the twin aim of capital growth. Over the past five years, MUT has seen an NAV TR of 53.4%, ahead of the peer group weighted average NAV TR of 46.6% and FTSE All Share TR of 33.2%. The key drivers of performance over the last five years have been the differentiated investment approach taken by the managers, in addition to the focus on quality companies which has led to strong risk adjusted returns and a five-year beta figure of 0.89 relative to the benchmark. With a patient buy and hold approach, Charles and Iain believe in

the importance of letting the fundamentals of a company shine through and do not regularly buy and sell holdings. The turnover ratio backs this claim up, and is relatively low at 18.3%, equivalent to an average holding period of more than five years.

Fig.3: Five-Year Performance Vs Sector

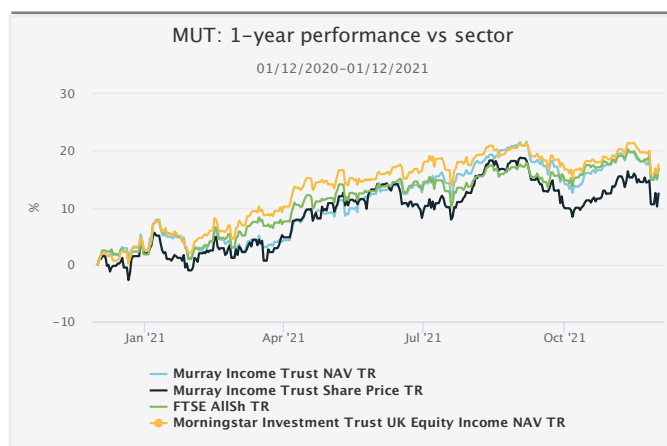


Source: Morningstar

Past performance is not a reliable indicator of future results.

Over the past twelve months to 02/12/2021, MUT has performed in-line with the benchmark and slightly below the peer-group index. MUT has delivered a NAV total return of 16.9% which is the same as the FTSE All Share Index return of 16.9% and below the Morningstar Investment Trust UK Equity Income NAV total return of 17.6%. It must be noted Charles and Iain do not pay attention to sector exposures; but instead focus on building the portfolio with quality holdings. During Q1 2020, MUT outperformed the benchmark and index, which the managers believe highlights the importance of focussing on quality companies especially in periods of market turmoil.

Fig.4: One-Year Performance Vs Sector

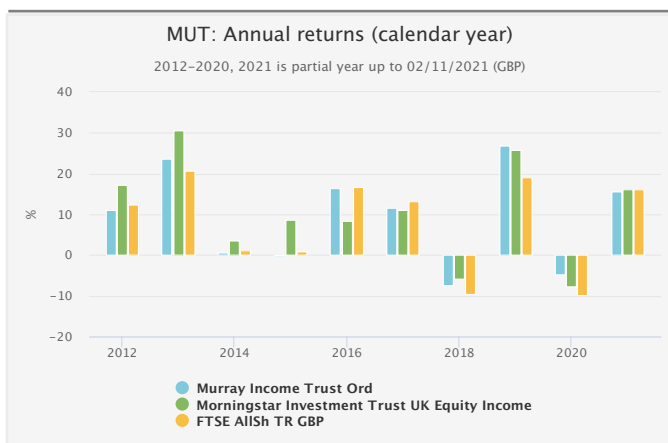


Source: Morningstar

Past performance is not a reliable indicator of future results.



Fig.5: Annual Returns



Source: Morningstar

Past performance is not a reliable indicator of future results.

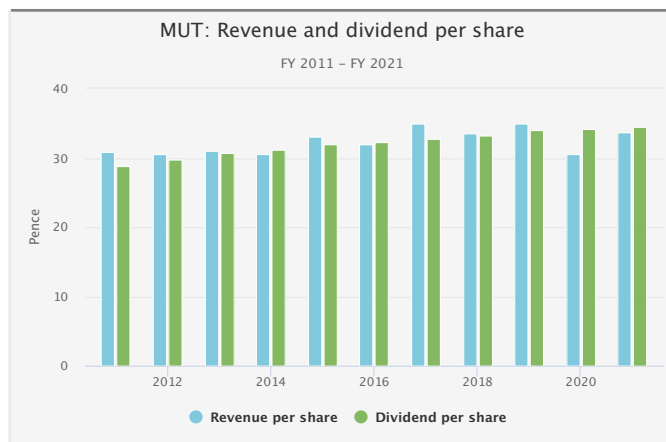
Dividend

As an income focussed trust, MUT pays four quarterly dividends in December, March, June and September, with the larger payment in September being the last of the financial year. MUT’s managers actively look to invest in companies with healthy balance sheets and strong business models. This helped to protect the trust avoid the worst effects of the COVID-19 downturn on revenues. Over 2020, dividend income for the trust fell by 4%, which compares to the income fall of the benchmark of 42% based on data from Link’s dividend monitor.

The managers use option writing to boost income, which helps to contribute to the stability of income earned by the trust. Typically, this constitutes between 5-7% of total income, but during 2020 option writing was contributing c. 10% of the income generated which greatly helped in maintaining the strong income generation. Overall, thanks to the focus on quality holdings and option writing, income generation for MUT was only down 4% from pre-covid levels.

As of June 2021, MUT had revenue reserves of 12.9 pence per share, equivalent to 37% of the 2021 dividend. This reserve has been helpful in supporting the progressive dividend, which has an unbroken record of increases for almost 50 years. The dividend for the 2021 financial year was 34.5p per share which equates to a c. 3.8% yield at the current share price. This full year dividend was 98% covered by revenue, and forecasts from MUT’s managers indicate that the current year’s income will surpass the dividend paid out last year, a quicker recovery than they anticipated in the depths of the crisis. As the reemergence from recovery from the COVID pandemic continues and holdings begin to generate increased incomes, the board of MUT could be in a position where dividend increases beyond the historical minimum levels of 0.25p per share might be possible.

Fig.6: Dividend And Revenues Per Share For Financial Years



Source: Morningstar

Management

MUT is managed by Senior Investment Director Charles Luke and Investment Director Iain Pyle. Charles is Senior Investment Director in the UK equities team and joined abrdn in 2000. Charles began his career at Framlington Investment Management in 1998 covering UK equities. Iain is the deputy manager for Murray Income Trust in addition to a position as lead manager for of Shires Income plc. Having been an Investment Director at abrdn across the UK equities team since 2015, Iain also manages the UK Equity High Income Fund and the Bothwell UK Equity Income Fund and is responsible for the oil & gas and banks sectors. Additionally, Iain is the covering analyst for the pharmaceutical and healthcare sectors. Prior to joining abrdn, Iain was a Vice President on the number one ranked European Oil and Gas research team at Sanford Bernstein in addition to having a career in consultancy at PwC. Iain is a qualified accountant.

Discount

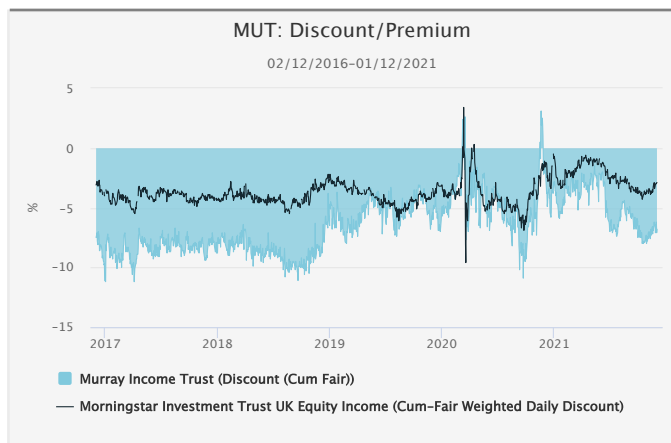
MUT has been trading on a discount for most of the past five years, as we illustrate in the graph below. Taking a five-year view, MUT has been trading on an average c. 6.4% discount versus the peer group’s simple average of 3.7%. As of 02/12/2021, MUT’s shares are trading on a discount of 6.8%, having widened over the last few months.

In November 2020 last year, with the publication of positive vaccine trial results, a reflationary rally saw the return of enthusiasm towards income stocks as hopes were raised that dividend payments could be increased. This saw a brief narrowing of the discount, and even a short-term premium at the start of 2021, however, one year on from the merger with PLI, whilst assets under management have grown, the average discount has



widened as investors again become nervous on the state of the UK's economic recovery. The board have permission to buy shares back, having last bought shares back on 03/11/2021 at a discount we estimate at 7.7%.

Fig.7: Five-Year Discount/Premium Chart



Source: Morningstar

Charges

The ongoing charges figure (OCF) of MUT is just 0.46%. This compares to the AIC UK Equity Income simple average of 0.82% according to figures from J.P Morgan Cazenove. On the back of the merger with PLI, MUT's managers gave a six-month fee payment holiday which has led to the management fee falling from 0.48% to 0.39%. However, investors should be aware this fee will likely be higher on an ongoing basis as the holiday has ended. The management fee reduces incrementally as net assets rise. A 0.55% management fee is charged per annum on net assets up to £350m, 0.45% per annum on net assets between £350m and £450m, and 0.25% per annum on net assets above £450m. Based on the current net asset value of £1.15bn, we calculate the blended management fee to be 0.36%. The KID RIY of MUT is 1.16% which is lower than the simple average of the AIC UK Equity Income of 1.43%.

ESG

MUT's annual report for the financial year ending June 2021 included more transparent information regarding the managers' approach to ESG with specific case studies referred to, highlighting how the principles are applied to the company's investment process. MUT's managers do not make investments on an exclusionary basis. Instead, they prefer to invest in companies with the greatest position to mitigate ESG risks or those with further commitment to improve their ESG score. MUT's portfolio has a AAA ESG rating from Morgan Stanley Capital International (MSCI) and abrdn make use of an in-house ESG scoring card which allows for combination of qualitative and quantitative ESG analysis of investment holdings.

Consistent to the approach at abrdn, the managers believe in active engagement with current and potential investments. This can range from providing initial guidance on suitable metrics through to holding the company accountable to deliver on promises. As a result of this, Charles and Iain are comfortable with investing across most sectors (excluding tobacco) so long as it is their belief that a company is taking the necessary action to address ESG related risks. For example, with an energy company this would be the belief that they are taking the required action to address the energy transition. In fact, MUT's managers have high ESG and financial expectations for companies in the energy sector given that many different fuel sources will be needed as we transition to a low carbon future. Evidence for the team's intensive and active engagement is Sirius Real Estate, where key ESG topics have been discussed by the team across 17 meetings with the executive team and a further three additional meetings with non-executives to date.

When screened on Morningstar, Murray Income Trust had c. 97.5% of assets under management covered by an ESG score. Overall, it is assigned an above average score versus the peer group by Morningstar for sustainability. With no specific investment exclusions, MUT is unlikely to appeal to investors looking for exposure to a strict ESG focussed investment trust. However, for investors looking for exposure to a portfolio of quality holdings where active engagement is incorporated within the investment process and where a focus is placed on allowing holdings to implement positive change over time, then MUT certainly could be an appealing option.



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