FUND PROFILE

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COLUMBIA THREADNEEDLE INVESTMENTS

THREADNEEDLE UK EQUITY INCOME

January 2021

RSMR RATED FUND

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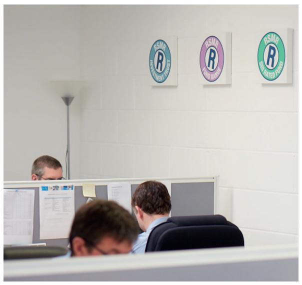

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THREADNEEDLE UK EQUITY INCOME

OUR FUND PROFILES provide an in-depth review of our leading rated funds and are designed to give advisers, paraplanners and analysts an 'under the bonnet' view of the fund. In providing more detailed commentary than a standard fund factsheet we believe our fund profiles set the standard for the next generation of research notes, aiding in fund selection and in meeting the ongoing suitability requirements expected by the FCA, and helping ensure firms deliver good client outcomes.

All of our rated funds are subject to rigorous and ongoing scrutiny on both a qualitative and quantitative basis. Our fund methodology is available for download from the RSMR Hub – www.rsmr.co.uk

Threadneedle UK Equity Income Fund ihas been one of our rated funds since January 2008. It is a UK equity income fund which launched in October 1985. The fund is a long only UK equity fund which invests only in UK listed stocks and has a target yield of at least 100% of the UK Index. The fund invests across the market cap spectrum, but typically with a bias towards exposure to large cap companies. Richard Colwell joined Columbia Threadneedle in 2010 and was co-manager on the fund until June 2016 when he took over as lead manager of the fund as well as becoming head of UK equity at Columbia Threadneedle. He has a long track record in UK equity income and has been part, throughout his career, of teams who have made notable contributions to investment management in this highly competitive sector.

The underlying investment philosophy is to invest in companies that the market has undervalued and can either grow their earnings or seek a re-rating in terms of capital value. Richard has a buy and hold strategy and typically holds onto a stock through the growth phase of the business as well as in the recovery phase, resulting in a portfolio balanced between growth and value stocks albeit with a value tilt. The portfolio will have between 45 and 55 stocks with Richard willing to take conviction positions in holdings away from the benchmark to generate excess returns over an investment cycle.

The Columbia Threadneedle team is one of the most well-resourced UK equity teams in the UK. The team has a diverse range of experience and backgrounds which helps encourage debate around stocks and ideas. Each member of the team is responsible for analysing stocks and providing research to the team, many of whom also manage portfolios. One of the greatest strengths of Columbia Threadneedle is the firm's collegiate approach and this has positively impacted across the firm's mandates.

Stephen O'Mara – Investment Research Manager, RSMR

Prior to joining RSMR in 2015, Stephen was Head of Investment Solutions at Ashcourt Rowan (formerly UK Wealth Management and Yorkshire Investment Group). Before that he ran the investment division of Pointon York and he worked as a discretionary portfolio manager at David Booler & Co. In these roles, he gained extensive experience in fund research, building investment propositions (advisory & discretionary) and working with clients, advisors & investment managers. He is a Chartered Fellow of the Chartered Institute for Securities and Investments, has a Diploma in Financial Planning and an Investment Management Certificate.

IA UK EQUITY INCOME SECTOR

The Investment Association defines the UK Equity Income sector as comprising funds which invest at least 80% in UK equities and which intend to achieve a historic yield on the distributable income in excess of 100% of the UK All Share Index yield at the fund's year end.

Given investors' need for income and the prevailing low interest rate environment, this is a very competitive sector with around 90 funds managing assets in the region of £51.6 billion (Source: Investment Association, 31st October 2018).

A high initial income or yield in a climate of low growth can provide an investor with a return ahead of inflation and so investing in equity income funds is a very pragmatic long-term investment strategy. In times of uncertainty, funds that can generate a defensive yield will fare better overall than pure growth-orientated alternatives. Equity yields have been relatively strong over the last few years outstripping the benchmark 10-year gilt on several occasions, and this has led to investors looking more closely at income generation as key to a total return strategy.

Income has always been an important part of overall return, but it is in the current difficult climate, which seems likely to continue, that investors refocus on income funds. The nature and discipline of paying a dividend often makes an income fund more defensive and value orientated, and this suits an uncertain economic backdrop. There are of course different strategies that managers can use, and a popular one is termed 'barbell' where the manager seeks to create the income from holdings paying strong dividends at one side of the portfolio, whilst seeking to boost growth and return prospects from the other side, often holding stocks with lower dividends but stronger capital potential. Other developments in the income sector include managers using derivatives to create additional sources of income using the UCITs and NURS rules.

The typical equity income fund can form an integral part of both an income and growth strategy if used sensibly in a portfolio – it makes sense, in the case of a longer-term growth strategy, that return from income is included. In some cases, the tax implications may reduce this impact but generally the benefits of having an ongoing income stream even during times of economic difficulty will enhance long term returns and help reduce the impact of falls in capital value.

COLUMBIA THREADNEEDLE INVESTMENTS

Columbia Threadneedle Investments is a wholly owned subsidiary of Ameriprise Financial, Inc. which is quoted on the New York Stock Exchange (NYSE). Ameriprise is a leading financial services firm based in the US. It is a leading US provider of Wealth Management, Annuities & Protection with approximately £388bn in assets under management (as at 30 June 2020).

Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies. It is the global asset management group of Ameriprise Financial Inc and manages funds for institutional and retail clients globally. The company employs more than 2,000 people, including 450 investment professionals in 18 offices around the world. Threadneedle Investment Services Limited and Threadneedle Asset Management Limited are authorised and Regulated in the UK by the Financial Conduct Authority (FCA).

THREADNEEDLE UK EQUITY INCOME

Manager	Richard Colwell
Structure	UK OEIC
IA Sector	IA UK Equity Income sector
Launched	31 October 1985
Fund Size	£3,695.8 million as at 30 November 2020

Fund Manager

The team is made up of 11 investment professionals who have a range of responsibilities with more sector and analytical work being carried out by the co-managers and deputy managers. As at, 30 June 2020, the team managed £18.5 billion in UK equities.

The team have a wide range of experience and expertise which is deliberate to encourage wider debate within the team and to provide a different outlook on stocks and the macro environment. To try and avoid group-think there is no house style with both value and growth investors within the team as well as the UK mid and UK small cap managers. All members of the team share their own research as well as jointly hosting company meetings.

Richard Colwell is head of UK equities and manager of the Threadneedle UK Equity Income fund. He has been in the industry 30 years and joined the company in 2010 as co-manager of the UK equity fund before being promoted to lead manager and head of UK equities in 2016. Before joining the company, Richard ran high alpha UK equity portfolios at Aviva Investors. He also held portfolio management roles at Credit Suisse and Schroders and worked at the Bank of England.

There have been a few changes to the team over the past 12 months, but these have been about natural progression and a more effective deployment of resource rather than anything else. The spine of the UK equity team at Columbia Threadneedle remains in place with some of the younger members continuing to be developed and given more responsibilities. There have been no new ‘big name’ additions or departures because they were not required. Columbia Threadneedle has a strong UK equity team, managing a range of core equity income, equity growth, small and mid-cap portfolios.

An additional resource recently introduced has been a centralised research hub to complement the capabilities of the Columbia Threadneedle UK team. It is anticipated that this will grow as it is an initiative of the US Boston-based CIO (drawing on the US based Columbia resource). Another initiative involves building upon the firm’s ESG capabilities with the development of a strong ESG resource being built into the global research hub. Columbia Threadneedle has always had strong credentials in assessing corporate governance but the latest developments will place a greater emphasis on the ‘Environmental’ and ‘Social’ aspects of ESG. The demise of ‘sell-side’ research capabilities has enhanced the need for firms operating on the ‘buy-side’ to enhance their internal research capabilities and this is a signal that Columbia Threadneedle recognise this. This is particularly important in under-researched segments of the market, to which this fund can be exposed. We see these two changes as being positive developments.

Fund Objectives & Targets

The fund has set out the following objectives and targets which it adheres to.

- The fund aims to provide income combined with prospects for capital growth over the long term.
- It looks to provide an income yield higher than the UK All-Share Index over rolling 3-year periods, after the deduction of charges.
- The fund is actively managed and invests at least 90% of its assets in the shares of companies listed on the London Stock Exchange; predominantly companies domiciled in the UK, or which have significant UK business operations.
- The fund selects companies that exhibit above average income generation potential, as well as those considered to offer opportunities more by way of share price or dividend growth. These companies may be selected from any industry or economic sector, and whilst there is no restriction on size, investment tends to focus on the larger companies included in the FTSE All-Share Index.

- The UK All-Share Index is regarded as an appropriate performance measure of the UK stock market, with over 600 companies currently included. The income yield of this index provides a suitable target benchmark against which the level of income generated by the fund will be measured and evaluated over time.

- The fund typically invests in fewer than 60 companies, which may include shares of some companies not within the index. The fund may invest in other securities (including fixed interest securities) and collective investment schemes (including funds managed by Columbia Threadneedle companies), when deemed appropriate.

Investment Philosophy

The manager believes that active fund management through cycles can produce attractive risk adjusted returns. Another key philosophy is that being patient and taking a long-term view will result in outperformance of the market, which is more focused on short-term news and pays less attention to the long-term potential of a business. He believes that fundamentals drive long-term returns and even if the market ignores these over the short-term, as long as the business continues to perform then this will come through in the long-term returns.

He will buy good businesses that are going through a difficult time but will also buy poor businesses that are under-priced. The analogy used is that it is good to spot a football team in the Europa League that has the potential to move into the Champions League, but you can also do well by finding a team in the relegation zone which could become a mid-table team.

Investment Process

The UK team at Columbia Threadneedle has 11 investment professionals who are all responsible for analysing companies and producing research for the wider team. All members of team undertake bottom-up company analysis by looking at a number of metrics and factors.

The manager has overall responsibility for the fund and any stock decisions rest with him. Idea generation for the fund is driven both by analysts suggesting stocks and by the manager finding new ideas. Company meetings can be a good source of new ideas with either competitors or companies within the supply chain being identified. Quantitative screens are also used to identify stocks which look cheap with further work then carried out. Once a company has been identified then a pragmatic approach is used to determine how to value the company. The metrics used when valuing stocks are dependent on which sector a stock is in and what factors the market focuses on. If the market is focused on the earnings growth of a company then free cash flow yield is given a greater weighting, whereas for a company whose valuation is determined by the dividend yield, the dividend cover and balance sheet strength may be given a greater weighting. Once the analyst has completed their analysis of a company then a note is sent around the wider team and debated in the weekly meeting.

If the manager likes the idea and agrees with the analyst's suggestion, he will then arrange a meeting with the company management and will typically see different levels of management including CEO, CFO and chairman as well as undertaking company site visits. Once he is satisfied the stock could be a position in the portfolio a price target is set, and the stock goes onto a watchlist. It is very rare that a company would go straight into the portfolio and will typically take a year from being first identified to enter the portfolio. The catalyst for entry is either the share price has reached the target price or sales from the portfolio mean that there is space for the new idea.

New holdings will generally be recovery stocks which are purchased before earnings or upgrades start coming through. Once there is sign of improvement and growth managers start buying the stock he will not automatically sell, where a recovery fund manager who would typically sell after the initial recovery. He will hold onto the stock if he thinks it has further upside in the price or if dividend growth is expected which will drive the share price in the long term. As evidence of this, the fund still has holdings that were bought 10 years ago as recovery stocks with the companies turning themselves around and still growing dividends today. He operates a buy and hold strategy and as a result turnover tends to be low.

The manager looks to identify stocks he considers good quality – but which are currently undervalued by the market. He is careful to avoid value traps, but instead looks for good businesses with a catalyst for change, which fall into three buckets: defensives which should perform well regardless of the economic backdrop, average risk which can be cyclical companies but which have little or no debt, and higher risk investments which could be highly leveraged or need some work to turn to profit.

He likes to take a long-term view, recognising that some of the investments, particularly in the higher risk bucket, may take time to realise what he considers to be their true value, and aims to buy and hold investments for some time, meaning low portfolio turnover.

Once a stock is in the portfolio then defensive research is continually carried out. Each stock is covered by an analyst who monitors the ongoing financials and operations of the business. If they believe that the stock is overpriced, or that the thesis has changed then they will challenge Richard on holding the stock. He has the final say on whether the stock stays within the fund or is sold. As well as the analyst monitoring the stock Richard also monitors all stocks in his portfolio and has regular meetings with company management.

When constructing the portfolio there is no yield requirement at stock level but at fund level there is a requirement for the fund of 100% of the yield of the FTSE All Share. The portfolio will be split between high paying dividend companies with low dividend growth, average paying companies with good dividend growth and a very small amount of zero dividend companies. The manager believes that a blend of these types of companies is necessary as they tend to behave differently under different market conditions.

On a stock basis, the fund has the UCITS rule of a maximum position of 10% in any one holding and a self-imposed guideline of no more than a 5% active weight in any one stock. The fund has no restrictions on sectors and may be zero weighted to large sectors if there is no value or a high degree of risk. The fund buys stocks across the market cap spectrum and has no target weighting to any particular area. The fund will generally have the majority of its holdings within large cap, but it is able to move this around if the opportunity is further down the market cap spectrum.

PAST & CURRENT POSITIONING/STRATEGY

From an operational point of view, the manager believes that the investment team has performed well throughout the Covid-19 crisis which has defined 2020. It has proved to be a period of more intensive people management but there have been no significant obstacles, apart from some minor logistics.

The focus on a five-year time horizon, as opposed to obsessing with the next twelve months has helped. In part, lessons were learnt in the global financial crisis, and a greater emphasis has been placed on scenario analysis with no short-cuts surrounding cash flows or the strength of balance sheets employed. Stock correlations have also been more in the frame but with a prevailing desire to invest with conviction. The significant fall out in March presented opportunities with some stocks looking ‘stupidly’ cheap. Examples include ITV and M&S which were even cheap prior to the Covid-19 crisis.

The persistent undervaluation of the UK market, relative to global markets and in particular, Europe which typically tends to trade closer to the UK than the US, continues to look abnormal. There are quality UK companies with a global book of earnings trading at deep discounts to the global market. For example, Unilever is valued as being in a different asset class to its peers P&G and Nestlé.

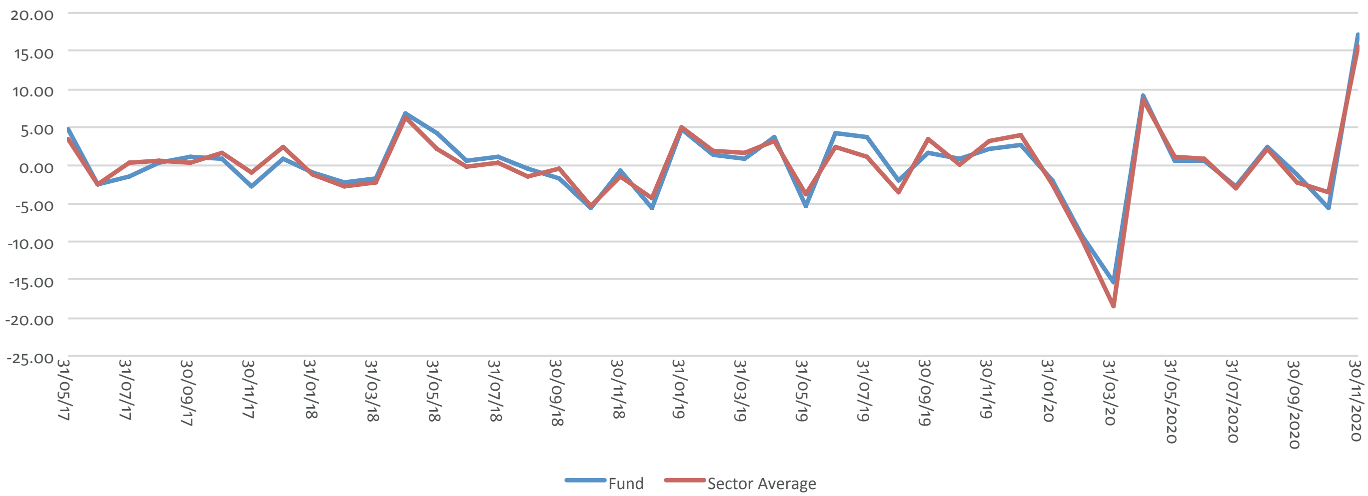
Significant arbitrage opportunities are available for overseas investors to take advantage of discounted asset prices. RSA, a UK based insurer with more than 300 years of history recently accepted a £7.2 billion bid from a consortium of Canadian and Denmark based companies which was at a 53% premium to its market price. The manager thinks there could be far more of this to come. If the stock market fails to recognise value, others will.

The fund has no yield requirements on individual stocks which allows the manager to invest across stocks with a wide range of yields. Yield is considered at portfolio level. A problem this year is that companies have been suspending or cutting dividends, given the outlook for profits and earnings. Initial estimates suggested investors would lose up to 50% of their income in 2020. In the meantime, 60 large UK companies have reinstated their dividends which means the outlook for equity income over 2020 (as a whole) will not look as bad as it did a few months ago. They might lose something like a little over a third of their income but in the context of income from bond markets (or lack of), things look a lot better than they did. The outlook also looks a lot better for the next twelve months and the fund is still yielding over 3.2%. It may take a couple of years for dividends to return to earlier (2019) levels, but bond yields remain depressed and there is no immediate catalyst for them to rise.

The strategy, to capture total returns and importantly dividend growth, positions the fund well in the current climate.

PERFORMANCE

Threadneedle UK Equity Income vs IA UK Equity Income Sector Average



Due to the contrarian approach, the fund's performance over the short term can be varied when compared to its benchmark and peers. The fund is willing to take large positions away from the benchmark and so if certain sectors drive the market then the fund can perform very differently, as seen in recent years.

In 2017 the oil and gas sectors continued to drive market returns but the market was very narrow and unless you held oil and mining stocks then it was hard to find returns elsewhere.

Between July 2017 and 2018 the fund was slightly ahead of the sector but again this was not a smooth journey. During the second half of 2017 the fund continued to struggle with oil and mining driving returns and the rest of the market lagging behind. In the first half of 2018 the fund performed well making up for the underperformance at the end of 2017. This was due to a number of the value names within the fund rallying strongly at the beginning of the year.

2019 saw the fund perform broadly in line with the sector. In absolute terms, the fund benefited from strong stock selection with several values stocks rallying from their lows.

This year has been tough for UK equities, particularly those with a value bias, due to the headwinds of the coronavirus and the continued Brexit uncertainty. This has worked against the portfolio, as some of the stocks saw big falls. Around ten fell by more than 60%, including ITV, Marks & Spencer and BT, but there were some winners which provided balance including Rentokil and Morrisons.

The breadth and depth of dividend cuts in the UK market has been severe. This is a process which comes at close of every cycle, but Covid-19 meant this was condensed into just three weeks. Sixty companies have already reinstated dividends and more will follow.

But looking ahead we expect more prudent policies and better cover, and even in the worst-case scenario the UK market should still offer a healthy yield premium to bonds by next year. For now, however, balance sheets and liquidity are paramount.

SUMMARY & EVALUATION

The fund is a long only UK equity fund which targets an overall yield of at least 100% of the index and invests across the market cap spectrum with the majority of holdings in FTSE 100 companies. The team look for companies paying a range of dividends providing them with a blend of high yielding stocks as well as lower yielding stocks with high dividend growth. The fund is actively managed and even though the current market cap and revenue exposure are close to the index, the underlying constituents are materially different with the fund holding less than 50 stocks.

Columbia Threadneedle have a strong team of UK equity investment professionals who all feed into the process, and all perform an analytical role. This provides a diverse resource for stock ideas as well as continual monitoring of existing holdings. The team do not rely on quantitative driven analysis and undertake fundamental research into companies as well as conducting company visits and meeting varying layers of company management teams.

There is no specific yield requirement for stocks, which allows the manager to select a diverse range of stocks from different sectors and at different points in their cycle. Typically, a stock will enter the portfolio as a recovery stock after either a valuation re-rating or due to operational issues, but the aim is to identify companies that have been undervalued by the market that turn around into a growth stock. The difference between this fund and other funds with this approach is that stocks are held throughout the growth phase which results in a lower turnover of stocks in the portfolio.

The performance of the fund has been strong over the long term but can deviate away from its peers and benchmark due to the contrarian approach if momentum in certain sectors drives the market.

This fund is suitable for investors who are seeking a good level of income and are comfortable deviating away from the index in the short term. It is a core UK equity income holding, managed by one of the most stable and long-standing teams in this field in the UK. The collegiate approach applied throughout Columbia Threadneedle is a great strength.

RSMR

Established in 2004 RSMR provides research and analysis to firms working across the UK's personal financial services marketplace.

Our work is completed with total impartiality, without any conflict of interest and delivered to a high professional standard by a team of experienced and highly qualified people.

Working with advisers

We provide specialist research, analysis and support to a diverse range of financial advisers and planners helping them to deliver sound advice to their clients, backed by rigorous and structured research and due diligence.

The main regulatory body in the UK, the FCA, states that personal recommendations made by advisers should be 'based on a comprehensive and fair analysis of the relevant market' and this has led to closer scrutiny of the whole advice process. Our solutions are designed to help advisers meet these challenges whilst recognising that advisory firms require a range of flexible options that best meet their own business needs and those of their clients.

Working with providers

We work with all the leading fund groups, life and pension companies and platform operators across the financial services sector offering straight forward and pragmatic advice to help add value and improve their business performance and efficiency whilst treating customers fairly in line with FCA requirements.

Ratings

Our innovative ratings are now recognised as market leading and cover a broad area of investment solutions including single strategy funds, SRI funds, Multimanager and multi-asset funds, DFMs and investment trusts. Our familiar 'R' logo is now recognised as a trusted badge of quality by advisers and providers alike and a 'must-have' when selecting funds. Our ratings are founded on a strict methodology that considers performance and risk measures but places a greater emphasis on the ability of fund managers to continue to deliver performance in the years ahead. based on our in-depth face-to-face meetings with fund managers across the globe.

We understand financial services and we will work alongside you to deliver tailored solutions that are right for your clients and your business.

Our research. Your success.

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