AJBell Investcentre

Fundamentals with Russ Mould

October 2016

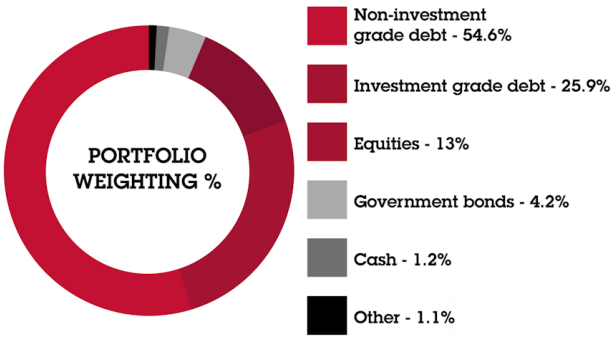
Hello, I'm Russ Mould, AJ Bell's Investment Director, and welcome to the latest edition of Fundamentals, where I'll be looking at one of the best-selling funds on the AJ Bell Investcentre platform at the moment, namely Artemis High Income.

[CAPTION - Artemis High Income QI (Inc)

ISIN – GB00B2PLJN71 SEDOL – B2PLJN7]

As its name suggests, Artemis High Income looks to generate an above-average level of income and indeed grow its income generating potential over time. That said, managers Alex Ralph and Adrian Gosden do seek to provide some long-term capital growth as well.

How? Well, the fund sits in Morningstar's GBP Cautious Allocation category, while its IMA sector is Sterling Strategic Bond, so there are a couple of clues, but here is the asset allocation according to Artemis' latest factsheet.



Source: Artemis fact sheet, Morningstar

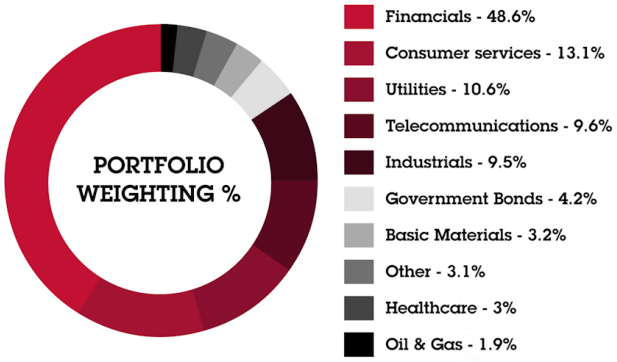
As we can see, more than 80% of the £1.2 billion in assets under administration are parked in bonds, just 13% in equities. The fixed-income portion leans toward corporate bonds and overall there are 117 bond holdings and 11 equity ones.

Just over half of the fund is in sub-investment grade debt, where the fund managers will be seeking additional yield to compensate for the additional risks, as the firms here will have less-than-pristine balance sheets. A quarter is in investment grade corporate debt with just 4% in UK Government paper.

The biggest stock holdings are FTSE 100 stalwarts Legal & General, BAE Systems and gas utility Centrica. Government stock represents the biggest single fixed-income position but other key holdings include debt issued by FTSE 100 non-life insurance firm RSA and mining giant BHP Billiton.

Overall, 94% of the assets are held in UK-listed securities, with just under 6% parked in Australia and a smidgeon in Emerging Asia.

By sector, financials, consumer services and utilities dominate the weightings as we can see here:



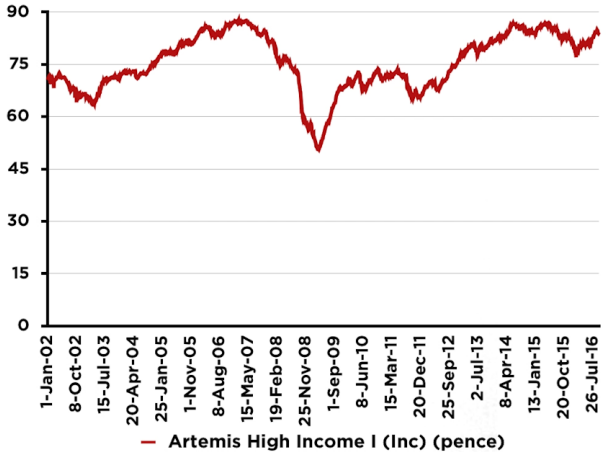
Source: Artemis fact sheet, Morningstar

The upshot of all of that is a 5.7% 12-month yield, paid quarterly. The ongoing charge is 0.69% and for those who place store in such things, Artemis High Income enjoys a five-star ranking from Morningstar.

So those are the mechanics and I think there are three possible reasons why advisers and clients are warming to this particular fund right now.

- First, the latest monetary policy moves from the Bank of England, US Federal Reserve and Bank of Japan may be leading advisers to conclude that interest rates – and therefore returns on cash – are going to remain lower for a lot longer than anyone dared imagine. The Bank of England cut rates in August and has hinted at a further trim in November; the Bank of Japan continues to experiment with ever-more exotic variations of negative interest rates and Quantitative Easing; while the US Federal Reserve left rates unchanged in September and cut its forecast for rate hikes in 2017 to just two. This all leaves clients looking for yield.
- Second, as a result, the fund's 5.7% yield will catch the eye of clients who are looking for income but prefer bonds to equities as a means of seeking out income for their portfolio pot – albeit in the knowledge this is riskier than the average corporate bond fund, owing to the sub-investment grade fixed-income and equity portions. This next graphic shows the performance of the fund and yield since 2002, when Artemis took over its management.
- Finally, bonds, like shares, require diligent research. Any bond comes with three main risks – credit risk (also known as default risk), interest rate risk (also known as market risk) and liquidity risk. A small selection of individual holdings could leave a client exposed to one, two or all three. In theory, a well-diversified portfolio will help to generate the targeted income and capital gains, while protecting the downside if inflation, interest rates or government bond yields suddenly surprise by spiking higher – as all three of those would probably hit bond prices. It also lessens the impact of any default by any single issuer.

This is not to say the fund is without risks – there wouldn't be a 5.7% yield otherwise.



Source: Thomson Reuters Datastream

This next graphic shows the performance of the fund since 2002, when Artemis took over its management. There have been a few lumps and bumps and a deep recession, real inflation scare or a sudden jump in interest rates could hurt. They may seem unlikely now but then I suspect none of us expected UK interest rates to stay at 0.5% for seven years …. and then go down, especially as what goes down can also go up, as we all know.

Thank you for watching and I look forward to seeing you next time

AJBIC/TS/T/20161005