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Currie secrets

Four groups dominate the competitive world of equity income, but a new fund run by the shrewd Scott McKenzie could be about to challenge their hegemony.

MARK DAMPIER FUND FOCUS

The equity income sector remains hugely popular among IFAs and clients alike. That is hardly surprising given that the twin objectives of increasing capital and income are exactly what so many retiring clients want. However, even those who are years away from retirement can see the benefit of compounding dividends that enhance the total return.

Not surprisingly, it is a competitive sector. Four groups take the lion's share - Jupiter, Invesco Perpetual, Artemis and Axa Framlington. Just outside this inner circle are F&C, Rathbone, Scottish Widows Investment Partnership and a new entry, Martin Currie UK equity income.

Martin Currie has never stood out in this area before. However, the group is now making a concerted effort to woo IFAs and retail clients.

Scott McKenzie joined Martin Currie in October 2005 from Morley, where he ran the Norwich Union equity income fund. Before that he was at Britannic (now Resolution) where he had a successful record in running its high-yield fund.

McKenzie has made a positive start, bringing the fund from the low rankings up to 16th and in the year to date the fund is up by a very respectable 16.5%. To put that in perspective, Jupiter income is up by 17.68% and the top performing Invesco Perpetual high-income fund is up by 22.13% so we may well have a new challenger on our hands.

The fund's objectives are to be top quartile in the IMA sector and to outperform the FTSE All Share index. The yield target is 120% of the FTSE All Share but there is also a focus on growing the annual income, which I think is very important.

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Taking into account a dividend forecast growth rate of 14% gives a predicted portfolio yield of 3.8%. It is a requirement that every stock in the portfolio pay a dividend but there are one or two IPOs which are currently not yielding but are on a high yield forecast.

The process starts by screening the FTSE All Share on a dividend basis for stocks that yield more than 10-year gilts (currently 4.5%) and with superior dividend growth of at least 7%. This portfolio is constructed from 25% high-yielding ideas and 75% from strong dividend-growing stocks.

As you might expect, the buying process is contrarian. McKenzie looks for unloved and unfashionable stocks, holding them through the pain and patience stages and selling them once they become fashionable.

The FTSE 350 screening process currently highlights 32 stocks from a high-yield perspective and 140 from superior dividend growth, with roughly one in four of these ideas ending up in the portfolio. In terms of market-cap breakdown, this gives it 58% FTSE 100, 20% mid-caps and 18% small caps.

The fund size is only £40m, which is tiny when you consider how much the big four are managing. I believe this must give McKenzie a good chance to catch up through some small and mid-cap stocks. That said, McKenzie feels that mid-caps are now generally overvalued and, given a trailing p/e of 20 times, he is probably right. His higher weighting in large caps is not necessarily part of the general consensus that they offer more value but because mid-caps look overpriced.

It has been an excellent first year for McKenzie and it would not surprise me if the fund was over £100m in a year. If he can continue this performance, he will find himself on more recommended lists. For those looking for diversification outside the main names, Martin Currie UK equity income is one to look up.