HIGHER INCOME FUND

COMMENTARY FOR QUARTER TO END JUNE 2021

PERFORMANCE

	3 Months	6 Months	1 Year	3 Years	5 Years	10 Years
Fund Performance (B Class)	5.01%	11.60%	21.55%	12.06%	38.11%	87.04%
FTSE AllShare TR GBP	5.60%	11.09%	21.45%	6.28%	36.86%	85.47%
IA Mixed Investment 40-85% Shares	4.97%	6.68%	17.39%	21.87%	48.79%	94.64%
Sector Quartile	2	1	1	4	4	3

Source: Morningstar. Figures compared on a Bid to Bid basis with Net Income Reinvested.

REVIEW

Global equities performed well over the second quarter of the year, as vaccination programmes continued to progress in the developed world. Treasury yields declined materially, which helped rate-sensitive global growth stocks recover some of the ground that had been lost to value stocks in the previous quarter. This provided a bit of a headwind for the Fund's value-oriented equity strategy, but the Fund nevertheless participated well in this quarter's rising markets due to a number of stock-specific factors.

PERFORMANCE & ACTIVITY

EdenTree Higher Income Fund returned 5.9% over the course of the quarter, outperforming its FTSE All Share benchmark, which returned of 5.6%. It lagged the FTSE World ex UK return of 7.6%. Fixed interest markets generally rose, with the FTSE Actuaries UK Conventional Gilts All Stocks rising 1.7% and the IBOXX Sterling Corporates rising 1.9%.

The Fund's asset allocation proved appropriate, with material allocations to the US, Europe, and other overseas equity markets that outperformed the UK, but ultimately the quarter's outperformance came primarily from stock selection within our core UK market.

Despite the declining yields, many areas of the market exhibited late-cycle characteristics, with Health Care and Utilities among the top-performing sectors in the UK. Within our UK equity allocation, we benefitted from exposure to these sectors, and were hindered by our allocation to Financials.

The quarter was characterised by a reversal of previous reflation trades. Some of the worst-performing positions in the Fund were names that provide access to steady income streams derived from real assets, such as our infrastructure investments through JLEN Environmental Assets and Octopus Renewables Infrastructure Trust (ORIT). We met with ORIT management during the quarter, and we remain confident that it should be able to continue to provide investors with sustainable income while continuing to grow its capital through investing in a range of assets and development projects that are likely to have a positive impact on the environment.

An infrastructure-related investment that certainly did not underperform over the quarter was Kier Group, one of the top contributors to outperformance over the period. The construction group conducted a successful placing, able to issue shares at a discount to the preceding day's market price, raising over £240m to pay down debt. This was taken well by the market. This was the latest step in a series of measures to improve its capability to generate free cash flow, having already successfully undertaken a number of cost-cutting measures and having sold out of its non-core housing business. We are pleased the market recognised this progress and, in our view, the stock is still trading at attractive valuations.

Other top performers included John Laing Group and BT Group. BT's share price rose sharply when Altice UK, a vehicle set up by the French-Israeli billionaire dealmaker Patrick Drahi, acquired a 12.1% stake in the company. Altice was explicit about that it was not preparing a takeover bid, but that it backed BT's existing strategy of aggressively investing in upgrading UK broadband networks to full fibre. While BT's share price has approximately doubled since its trough in 2020, this move from an investor known for targeting significant returns for his investments could well serve to underpin valuations at current levels and even endorse the view that there could be more to come.

The dividend payment for the fund dropped from around 6.3p in 2019 as a whole to around 4.7 for 2020 as a large number of companies ceased or cut dividend payments in reaction to Covid-19. Conditions improved in 2021 with many companies restoring dividends though sometimes at a lower level than prior to the crisis. We've seen a considerable improvement in prospects for the full-year dividend as more companies, especially the banks, return to more normal levels of dividend distribution.

The largest transaction over the period was the purchase of Mapfre SA, a Spanish composite insurance company with life assurance, general insurance and reinsurance in Spain, Portugal and Latin American countries as well as other international markets. The company was trading on a sharp discount to book value, a low price earnings ratio and offering a dividend yield in excess of 7%. The company also has strong ESG policies and is over 60% owned and

controlled by a charitable trust whose ethos flows through the company and ensures most profits ultimately go to charity including providing PPE during the Covid outbreak to developing countries.

In terms of other trading activity we increased exposure to some high yielding Asia names with purchases of the Hong Kong based 'Tetrapak' play, Greatview Asceptic, and the learning toys manufacturer, VTech. We also added to our banking exposure through purchase of ABN and Lloyds as we feel the sector is materially undervalued, well capitalised, should benefit from the stronger economic environment and prospect of interest rates when central banks are forced to begin tightening monetary policy as inflation becomes increasing concern. We reduced exposure to the oil sector which has benefited from the rising oil price but we believe to be vulnerable on a medium term basis to over-supply.

OUTLOOK

Despite markets remaining sanguine about the prospect of higher inflation and rate-rises on the horizon, there are plenty of global economic indicators, such as US GDP, that are showing very strong growth. Although these rises are relative to a low base, we think they should give investors pause for thought. We are seeing rising prices for commodities as well as consumer goods and, in some cases, rising wages, which could create a spiral of persistent inflationary pressures. Corporate earnings have surged after the pandemic, with US Q1 earnings particularly buoyant, having risen by almost 50%. Meanwhile the US government, which recently finalised a $600bn infrastructure spending deal, is showing no sign of slowing down its stimulus.

We believe the Fund remains well-positioned to benefit from the strong recovery in economic activity through its exposure to value cyclicals, and we believe it is precisely those holdings that underperformed over the last quarter that are best placed to mitigate against rising inflation.

To obtain further information please speak to your normal EdenTree representative, visit **www.edentreeim.com** or call our support team on **0800 011 3821**

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