

Newton Webcast Filming
 Raj Shant and Fred Moore – Newton European Higher Income
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Time Code	Transcription
00:00:00	Hi I'm Raj Shant, head of European equities at Newton.
00:00:03	Hi I'm Fred Moore, I'm the alternate manager on the European Higher Income strategy.
00:00:16	We think income investing works for a few reasons: the first reason is that a dividend is a real thing. It is a direct participation in the economic success of the company and once the company gives it to you - it can't take it back. The second thing is, Raj and I, we both believe that income investing provides some hedge against inflation. A company can pass on higher input costs in the form of higher prices. In other words, if it has pricing power, then it is an inflation hedge, and that it is really what distinguishes an equity from a bond: it is the ability to pay more out, year-on-year. Thirdly, we think that when the management has to pay a dividend year-on-year, it imposes a discipline on them to run the business for cash, and oddly it is something that Raj and I call the "paradox of yield". It forces the management, because they are constrained in their capital, they have to find cash for us year on year to actually really analyse each investment decision closely, and prevents them going out on certain wasteful acquisition M&A strategies. And lastly, there is for all of the above reasons, and also there is empirical evidence that income investing works. Certain studies show in Europe, but one specifically from Morgan & Stanley from 1926 to 2009, that if you reinvest dividends you get a compound growth in the total equity basket of 5.6% and that compares to 1.3% if you don't reinvest dividends and that's a real big year-on-year difference.
00:01:51	That is the power of compounding.
00:02:01	Investing in equities for income is much more popular in the UK than it is in other markets. However when you look at Continental Europe, so Europe excluding the UK, there is a real plethora of world class companies with high and rising dividend yields. So at last count there are 350 companies in Europe excluding the UK that yielded over 3% and had a market cap of over €500 million. Compare that to the UK, which had about 90 such companies, you can see why investing in Continental Europe for income is a great way of diversifying your investment. So people like Fred and myself have a pretty broad range of opportunities to choose from when we build an equity income portfolio.
00:02:46	There is actually a story here that is actually not that well-known and that is that Europe is actually, according to certain studies, is actually the fastest-growing dividend-paying region. Whether it is because Europe is maturing in terms of dividend culture compared to, say, the UK, but Soc Gen, for example, predict that dividends relating to Europe in 2010 and 11 will grow faster than all other world regions, that is including Asia Pacific, that is including North America.
00:03:20	2010 was a tough year for higher-yielding equities in Europe as in the rest of the

	<p>world. First let's just spend a moment on why that was: around the western world, interest rates were locked at 0 or near 0, and that actually had the effect of rewarding companies that were heavily indebted. Companies that had poor cash flows and high levels of debt benefitted most because they had to pay the least interest on their debt. Now those are not the kind of companies that Fred and I would look for: we want companies with strong balance sheets, strong cash flows, high and rising dividends. Now these kinds of companies are actually penalised over the last year, and a little bit more in fact, because having cash on hand is kind of crazy when you get such a low return on it. So high-yielding equities did over-perform in 2010, but we would envisage that if inflation does start to rise, and interest rates do start to rise as we go forwards, the environment will change materially in favour of these more solid, better-run companies.</p>
00:04:29	<p>Raj and I, we are often asked actually what constitutes an income stock and we go about finding that within the strategy. It is our strategy to buy stocks that should yield, on a forward-looking basis, 15% more than a local country benchmark in a very volatile recent market. For example, in the credit crisis, with banks not paying out dividends, our strategy proved successful in avoiding those stocks, and thus the pay-out has been resilient on the European strategy.</p>
00:04:59	<p>The thing that we really want to emphasize is that investing in equities for income in the long-term is a dominant proportion of the long-term investor's returns, even though it is an often-neglected area. Secondly, the UK is the spiritual home of investing equities for income but Continental Europe, Europe excluding the UK offers a great plethora of world-class companies and real diversification for equity income investors. Thirdly, we think that European dividends are likely to continue to grow reasonably strongly from here, and at Netwon we have a strong equity income strategy that is clear. It is disciplined and we believe we are going into the kind of environment that should yield strong returns from this kind of strategy.</p>

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