Investment

New rules tip the balance for Woodford

Invesco Perpetual's star manager is leading an exodus from the UK equity income sector after he refused to change his strategy, says **Chris Salih**

The UK equity income sector is set for a further shake-up following the Investment Management Association's latest announcement on yield requirements.

The IMA announced it was launching a new UK income and growth sector from January 1 to accommodate funds struggling to meet the UK equity income yield requirement of 110 per cent of the FTSE All Share index. IMA research found many funds were unlikely to meet the new requirements by the deadline of December 31, 2008.

Invesco Perpetual has already announced that Neil Woodford's income and higher-income funds will leave the UK equity income sector.

Invesco says the IMA's new yield requirement contrasts with Woodford's objectives and he is not willing to amend his investment horizons, which are over five and 10 years. Invesco says the IMA is forcing managers to focus on short-term yield at the expense of the long-term balance between income generation and capital growth.

Head of distribution Ian Trevers says: "We acknowledge the desire from certain parts of the industry for simple annual yield-testing within the equity income sector but we do not believe that the interests of our clients in these particular funds are best served by focusing on such a short timeframe."

"I would like to reassure clients and their advisers that this sector change will not impact on the way investments are managed. We will continue to aim to provide investors with a growing level of income balanced with the opportunity for capital growth over the long term."

Hargreaves Lansdown investment manager Ben Yearsley believes the new UK income and growth sector will only serve to confuse investors. He says: "If you look at Woodford's long-term record, he produces more yield than most managers and he runs his fund on a total-return basis. I really think the new sector is a waste of time and that perhaps the better route to take was to change the yield requirement to 100 per cent of the FTSE All Share, as that would possibly have levelled the playing field."

From January 1, the IMA has moved all UK equity income funds that failed the yield test on a review of the past 12 months into the new sector, provided they meet the sector's own definition, which is that funds aim to produce an historic yield of 90 to 110 per cent of the FTSE All Share yield at the fund's year-end.

However, a number of firms favour the stricter definition of UK equity income. T Bailey analyst Elliot Farley says: "We have said all along that if a UK equity income fund cannot regularly make 110 per cent of the yield of the FTSE All Share index, it is not really trying and therefore does not deserve to be called an income fund.

"Introducing an income and growth sector with a lower band of 90 to 110 per cent of the yield of the FTSE All Share sounds like a pacifier to those very big so-called income funds which may be good at growth but do not make the grade on income. There is already a sector for them, it is called the UK all companies sector. All this will achieve is to confuse matters and lead to funds yo-yo-ing between sector definitions."

Liontrust chief executive Nigel Legge says failures to comply with the yield targets have led to a misunderstanding by investors when selecting a UK equity income fund.

He says: "An investor seeking an income above index-linked gilts, for example, might have chosen a relatively low-yielding fund by focusing on funds with the best total returns over a short time period.

"Such action enables advisers and their clients to compare apples against apples rather than apples against pears. Some investors want an income yield that is higher than index-linked gilts and is growing while others accept funds with a lower yield and potentially lower volatility."

The Newton higher-income fund has looked to focus on yield, returning 6.69 per cent compared with the market average of 4.67 per cent, according to Datastream figures at November 28, 2008.

BNY Mellon Asset Management head of international distribution Paul Feeney says: "In recent years, the IMA UK equity income sector has attracted criticism for the fact that a significant minority of its funds made little effort to deliver the yield required by the IMA. The IMA has moved to address this and now all UK equity income investors stand to benefit.

"This is great news for income investors. We were supporters of the transition when the Newton higher-income fund's performance was struggling but now market conditions again favour our approach, the fund is rising towards the top of its sector. Removing the 30 or so funds which fail to deliver the required yield could see us start 2009 as one of the higher-ranked UK equity income funds."

Informed Choice director Martin Bamford says: "It could well affect the funds that we select as changes in sector also mean changes in criteria."

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