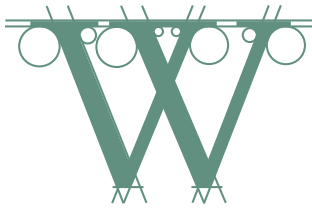


Looking to equity income funds for opportunity

August 2010



While equities were out of favour in the last quarter, there are a number of reasons to suggest that now is actually a good time to invest in an equity income fund as part of a diversified portfolio. Investors should consider several factors when choosing a fund, however, not least the advantages of using call options to increase distribution yield and reduce overall portfolio volatility.

Current dividend yields look attractive

For only the third time in the past decade, the dividend yield of the FTSE All-Share index is higher than that of UK government bonds. The prior two occasions were in early 2003 and late 2008, both of which were near key turning points for markets. While the situation this time around could differ somewhat given that not all areas of the equity market are cheap in a long-term context, the yield comparison does highlight that investors are currently paying a significant premium for the safe-haven status of gilts relative to equities. Furthermore, some of the large-cap stocks in the marketplace are yielding

more than 5%, have growing dividends and generate revenues which are ideally placed to withstand continued economic weakness.

Current conditions are not necessarily negative for equities

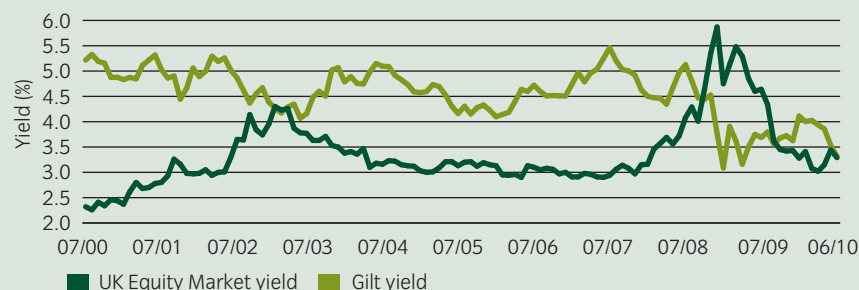
With leading indicators of economic growth coming off the highs, investors are justifiably nervous about investing in stocks at present. Yet not all factors point to a fall in equity prices from current levels. In the short term, falling levels of inflation and continued global growth should offer some support to the equity markets and enable central banks to keep interest rates low.

This in turn provides investors with an incentive to look to stocks to generate a higher return on their investment. It is also our view that a double-dip recession is unlikely, and as such, equities with low valuations should be reasonably well supported going forward. In addition, investors worried about the prospect of rising inflation in the longer-term should take some comfort from the fact that companies normally see revenues rising alongside higher price levels. In an inflationary environment therefore, equities with low valuations could still be well placed to offer investors real returns.

Issues to consider when looking at income funds

When choosing an equity income fund, there are a number of issues which investors should take into consideration. Not least is the issue of how much exposure a fund has to the sterling / US dollar exchange rate, given that a number of large UK companies pay their dividends in dollars. Exposure to dollar-dividend companies can support income in times of crisis given the dollar's

Chart 1: UK equity market yield vs gilt yield



Source: Insight and DataStream

➤ A BNY MELLON COMPANYSM

More insight. Not more of the same.

Insight
INVESTMENT

safe-haven status, but equally can reduce the distribution yield if sterling recovers. Secondly, investors should not be put off by funds which continue to hold stocks that have cut their dividend. Historically it has usually been right to continue holding such companies, as their total return potential often remains attractive. Furthermore, examples such as Rio Tinto and Rexam show that dividends can be quickly reinstated.

Value in large-cap stocks

With the western world now facing an environment of lower growth than before the financial crisis, investors could be encouraged to pay a premium for those stocks which should continue to be able to provide reasonable rates of revenue growth. Large-cap stocks look attractive from a valuation standpoint, with many of the big names in the oil & gas, telecoms and pharmaceutical sectors currently trading on single-digit price-to-earnings multiples. As such, Tim Rees, the highly-rated manager of Insight's Equity High Income and UK Equity Income Booster Funds, has a strong focus in these areas. Furthermore, a number of stocks with strong dividend yields have significant exposure to emerging markets, which should benefit from higher growth rates. GlaxoSmithKline and AstraZeneca, for example, are both UK-listed companies which have an increasing proportion of their earnings coming from the Far East. We are also positive on large life insurance companies such as Legal & General and Aviva. They are lowly rated by the market, yet could benefit from the developed world's need to boost savings rates. In contrast, we are cautious of credit-dependent domestic

stocks, such as UK housebuilding stocks, as leverage levels of UK households remain very high.

With gilt yields near historic lows, and an environment which is not unfavourable for equities, investors should consider having exposure to equity income funds within a diversified portfolio. Those equity income funds which combine the use of a call option strategy with a focus on large-cap value stocks should be particularly well placed.

Use call options to reduce volatility

Richard Lloyd, Head of Structured Solutions at Insight, and co-manager of Insight's UK Equity Income Booster Fund, believes that investors should also consider the benefits of investing in a fund employing a call option strategy to enhance income. Call options on a security are sold to buyers for a price known as the premium and are options to purchase a security at a specific level called the strike price. If the security price subsequently rises above this level, then the option is worth the difference between the current security price and the strike price; if not, the option has no value. A small but growing number of equity income funds use call options to boost the yield on their portfolio and reduce volatility. These funds sell call options, thus capping some of their upside potential, but use the premium received to boost distributions, resulting in a higher income for investors. In times of high volatility, for a given amount of premium, there can be a higher strike price, so there is less chance of upside

being lost due to the call option being exercised. When overall market direction is lacking, income funds using a call option strategy could represent an attractive proposition for investors. This is because they have the potential to offer an income above the market average, meaning that investors can enjoy a return from their holdings even in the absence of underlying capital growth.

For further information please contact:

Institutional Business Development

business.development@
insightinvestment.com
020 7321 1547

Wholesale Business Development

brokersupport@bnymellon.com
0500 66 00 00

International Business Development

internationalsales@bnymellon.com
+44 (0)20 7163 2367

European Business Development

europe@insightinvestment.com
+44 (0)20 7321 1928

www.insightinvestment.com

Telephone calls may be recorded.
Call charges may vary by provider.

The value of investments and any income will fluctuate (this may be partly due to exchange rate fluctuations) and investors may not get back the full amount invested. This document is only directed at investors resident in jurisdictions where our funds are registered. It is not an offer or invitation to persons outside of those jurisdictions. Insight Investment reserves the right to reject any applications from outside of such jurisdictions. Unless otherwise attributed the views and opinions expressed are those of the fund manager at the time of publication and are subject to change. The content of this document is valid for one month from date of issue.

Issued by Insight Investment Funds Management Limited. Registered office 160 Queen Victoria Street, London EC4V 4LA 1HZ. Registered in England and Wales. Registered number 01835691. Authorised and regulated by the Financial Services Authority.

➤ A BNY MELLON COMPANYSM

www.insightinvestment.com

Insight
INVESTMENT

07641-08-10