PILLING & Co
STOCKBROKERS LIMITED

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Dividend Heroes

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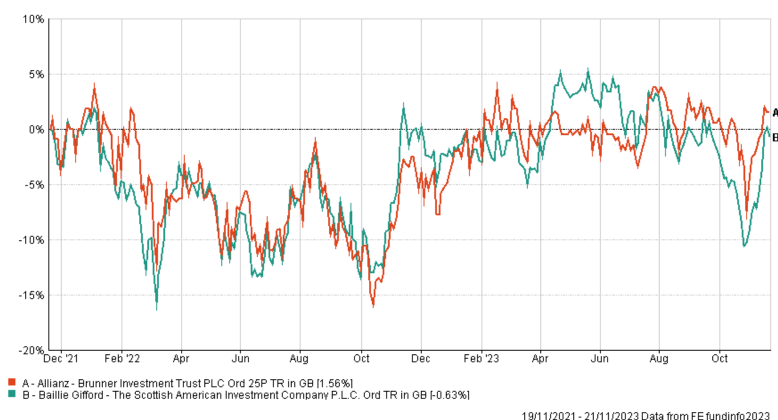
It has become apparent over the last eighteen months, that growth equities have not fared well in a high inflation, high interest rate environment. There are many factors contributing to this outcome, one is the alternative investment options available to investors during these times. For example, if inflation is at 5% and interest rates are at a similar rate, the cost of an investment into a long duration equity (one that is not profitable this year or perhaps for several years into the future) becomes considerably higher because there are assets available that will provide an instant return on capital invested today. For many this has been a sharp learning curve because we have not been in this environment since the financial crisis forced central banks to slash rates, which was later exaggerated further during Covid when rates troughed at 0.1% in the UK. During such times, those long duration assets were seen as credible options because the alternative for that investment capital was negligible, and hence the opportunity cost of holding was also negligible.

The adjustment investors have had to undertake, has come with an understandable level of wariness as many of us do not want to make a knee jerk reaction and sell a growth asset, only to find once they have recycled the proceeds into an income bearing one, the economic backdrop has changed once again. Here is the dilemma, although it doesn't have to be the case as there are a number of investment trusts and funds that offer you access to both income and growth, albeit the growth may come from increased dividends year on year which when compounded provide investors with a highly attractive return.

The Association of Investment Companies issues a list of investment trusts titled 'Dividend Heroes'. The criteria to qualify for such an accolade is for the trust to have increased their annual dividend for twenty years in a row. Interestingly, the breadth in terms of variety of different sectors has increased in recent time into areas investors may not have associated with dividend growth, such as Henderson Smaller Companies Trust which yield 3.5% and trades at a 11% discount to net asset value. Of course, a more obvious place to look is the UK Equity Income sector, and indeed there are three investment trusts that have surpassed the twenty years of increased annual dividend payments threshold comfortably, with **City of London**, **Murray Income** and **JPMorgan Claverhouse** boasting more than fifty years of dividend growth.

Thinking back over fifty years, and the trials and tribulations experienced in equity markets, that is quite an astonishing record. It should be noted the yields these trusts offer, are 5.1%, 5.0% and 5.3% respectively. In capital terms, during the last ten years, these trusts have grown 6%, 5.5% and 12.1% respectively. On a total return basis, this has comfortably beaten inflation during the same time frame.

Perhaps less well known are those trusts providing a source of income internationally, with names such as **Brunner** and **Scottish American**. Given their underlying make up of overseas assets, these trusts typically carry lower yields than their UK counterparts, paying dividend yields of 2.1% and 2.8% respectively. In terms of capital growth, however, this is where they come into their own by comparison to the UK names mentioned above. Over the last ten years, the trusts are up a whopping 106% and 97% respectively. Perhaps more surprising is the discount to net asset value for these two trusts, (especially when compared to the UK equivalent that trade close to their underlying asset values), with Brunner on a discount of 15.5% and Scottish American on a 3.3% discount.



Investment trusts pose a structural advantage when it comes to dividends, as they do not have to pay out all the income generated from the investments held in the portfolio in any given year. They are allowed to set aside up to 15% which goes into revenue reserves and then use this excess income to maintain or increase their distribution when the underlying companies may be cutting theirs – a prime example of this was during Covid when we saw many companies cut their dividends forcing many peers to follow suit. For the names mentioned above, this is a valuable feature and enables the boards to pay consistently rising dividends through both good and bad years.

If you would like further details about any of the investment trusts highlighted above, please do not hesitate to get in contact with your dealer or advisor at Pilling. There are key investor information documents available upon request as we require confirmation from potential investors that they have read this document before making the investment.

Discrete 12 month Performance (%)	Oct 23	Oct 22	Oct 21	Oct 20	Oct 19
Brunner TR	4.7	-2.6	36.5	-3.7	14.7
City of London TR	-0.1	5.1	32.6	-21.6	8.7
Henderson Smaller Companies TR	-10.5	-36.5	54.8	-6.9	10.7
JPMorgan Claverhouse TR	-0.1	-7.8	48.3	-21.0	5.3
Murray Income TR	6.2	-10.9	31.2	-12.6	22.2
Scottish American TR	-1.2	-3.3	23.7	5.4	17.3

Source: FE Analytics

More than one way to generate a return

Investing in ISAs, also known as **Individual Savings Accounts**, has for many years been the bread-and-butter advice for all clients at Pilling & Co. Why not make the most of any tax breaks that are offered to you as investors? After all, there aren't many. In every tax year you can subscribe up to £20,000 into an adult ISA or alternatively £9,000 into a Junior ISA. This can have a profound impact over the years on dividends and interest generated from investments held within the wrapper. Sadly, in the current market environment, capital gains are somewhat few and far between, although the importance of utilising an ISA was highlighted recently when Jeremy Hunt cut the capital gain tax allowance from £12,300 to £6,000 this year and to a somewhat anaemic £3,000 the next tax year.

Whilst it might seem I make light of what has been an extremely difficult market for investors to navigate, I am merely suggesting not to let a crisis go to waste. In this instance, I would refer to the idea of selling those holdings at depressed levels and buying them back in the ISA on the expectation that there will be a recovery in the future and capital appreciation will be tax free, providing you flexibility to exit a position (if you chose to do so) as opposed to fearing a large capital gains tax bill. To go a step further, if selling an asset that resulted in a loss being made, it could be a good opportunity to sell a longer term holding in your portfolio that is potentially making a healthy profit to offset against that loss. You do not lose exposure to that investment as you are simply buying those holdings back inside the ISA. For any investors exploring the 'Bed and ISA' service we provide, I should highlight we charge commission either on the sale or buy back. You should also be aware stamp duty will be charged if applicable and take into consideration any spread on the buy and sell price of equities.

As I alluded to above, many investors with Pilling will be only too aware of our ISA service, but perhaps less well known is our ability to open a **Self Invested Personal Pension (SIPP)** on your behalf. Pensions have always been a topic of discussion for clients, however since Jeremy Hunt made two large changes in the annual budget towards the tax structure it may be worth highlighting the benefits in this newsletter.

More than one way to generate a return cont'd

The first point of change was the maximum that could be subscribed to a pension in any given tax year, which increased from £40,000 to £60,000. Please note that the maximum subscription includes tax rebates, and you are not allowed to subscribe more than your earnings in a tax year. For example, if your salary was £50,000, that is the maximum you could subscribe gross. One silver lining to this however, is you are entitled to go back three years using pension carry forward, therefore, in this year for example, you could subscribe a maximum of £140,000 to your pension, £60,000 for this tax year and £40,000 in the previous two tax years. For super high-rate earners with an income above £200,000 a year, there are restrictions in place which may lead to the annual allowance gradually being reduced to as low as £10,000 in the current year.

The other change made related to the **Lifetime Allowance (LTA)**. In essence this is the value your pension can reach before an additional tax is levied on any amount above it – either a one off 25% charge on income or 55% if paid as a lump sum. The Chancellor also announced that the LTA has been abolished which makes it simpler to understand.

The benefits of subscribing to your pension can be very attractive, such as the tax rebate you are entitled to for each contribution. If you are contributing taxed income to your pension and you are a basic rate taxpayer, you will be entitled to 20% of the amount contributed as a rebate. Therefore, for every £10,000 contributed, a further £2,500 will be added to your investment pot as the contribution is grossed up. A higher rate taxpayer can achieve a greater amount, the tax rebate in the pension remains, but you can also claim a further 20% against the income tax paid during the tax year. In essence, for every £100 contributed to a pension, it technically only costs you £60. If you are a super high rate earner no further tax rebates are applicable. However, one very interesting aspect is for those earning over £100,000. The reason for this is because for every £2 over £100,000 earned you lose £1 of the nil rate band. The nil rate band for income tax is £12,570, therefore, if you earned £125,140 you would lose the full nil rate band entitlement, resulting in a 20% charge on what should be tax free income (£12,570 personal allowance).

Therefore, if you earned £125,140 you would be charged 60% on £25,140, meaning you would pay tax of £15,084.60 for earnings between the two bandings. If you contributed £25,141 (gross) to your pension, you would bring your annual income below £100,000 and so below the threshold and the tax rate would be back down to the marginal rate of 40%, not the 60% stated above. Hence the title of this article being more than one way to generate a return, as I hope I have illustrated that by contributing to your SIPP the tax benefits can be material in a year of low growth.

Of course, there are downsides to contributing to a pension, firstly the ability to access the funds contributed. The retirement age in the UK has risen from 55 years of age to 57 today and one shouldn't rely on that bracket not being increased if you are a younger investor and therefore something to consider, especially if you are aware of up-and-coming large ticket expenditure i.e., a house purchase or a wedding. Secondly, I have highlighted the reform to pensions that took place this tax year, there is threat of further regulatory changes which typically provides very little maneuverability for those funds already committed. Finally, like all investments, the nature of the wider markets will impact the pension investment performance although I would argue you have a longer investment time horizon, which should be seen as an advantage.

From the age of 57, you are entitled to take a lump sum of capital tax free from the pension, up to 25% of the total pension value at the point of crystallisation. Beyond the lump sum you can then move into a pension drawdown, which enables you to take an income from the pension, this amount will be charged at your nominal tax rate. To finish, one other important aspect to know about pensions is the potential to use it as an estate planning option. Pension funds are exempt from inheritance tax when you die as they do not form part of your taxable estate. Your beneficiaries may have to pay income tax on inherited pension savings depending on the age of the deceased – if before age 75 your beneficiaries can draw on the money tax-free.

Whilst I have attempted to set out the basics surrounding pensions as well as the recent changes set out in the Annual Budget by Jeremy Hunt, we strongly advise you to speak to a financial advisor before pursuing a pension plan. If you would like some assistance, I can happily put you in touch with an advisor. Pilling has a long relationship with AJ Bell as we use their sister company Invest Centre to provide our clients with a low-cost pension if they wish to open the service. Please do get in touch if you would like to find out more regarding our ISA and pension services.

Important Information

The value of investments and income can fall as well as rise and your capital may be at risk. Past performance is not a guide to future returns. Any opinions are not advice, if you are unsure about suitability, you should take independent advice. Any relevant HMRC or tax rules may be subject to change. Opinions and information are correct as at the time of writing and sources are believed to be reliable. Staff members and/or the author may hold the investment featured and receive renumeration linked to transactions in the recommendation. Where featured, prices are the most recent market price, not price targets for investment decisions. All investments are subject to our current terms and conditions. Whilst every effort is made to ensure accuracy, we cannot be held liable for errors or omissions.