

## A compelling case for Europe

### EQUITY INCOME FUNDS

Income potential from European companies has been largely ignored in the UK, but boutique Argonaut has profited in this sector, writes Gill Wadsworth

Equity income funds are a well-established part of the UK fund scene. Indeed, they have long been regarded as core holdings, and Invesco Perpetual's £6bn (€7.5bn, \$11.7bn) Income fund, run by Neil Woodford, is one of the biggest and most successful funds in the UK.

But the vast majority of equity income funds are a home-grown phenomenon, investing in the UK stock market.

The income potential of European stocks has been largely ignored by the investment management community. A widespread scepticism has seen just a handful of European equity income funds launched as providers opt for traditional European equity funds or high alpha alternatives instead.

However, one of the few products of this kind on the market will mark its third birthday this year and the managers behind it believe there is much to celebrate.

Barry Norris and Oliver Russ, founders and partners at specialist European equity boutique Argonaut, believe

their faith in the ability of European companies to deliver significant dividend income has paid off.

Mr Russ says: "People think Europe is a low yield market compared with the UK, but half of the income funds in the UK sector do not meet the Investment Management Association requirement [of being 80 per cent invested in UK equities and yielding more than 110 per cent of the FTSE All Share yield]. We have managed to get 4.9 per cent net from pure European equity without using structured products or derivatives."

Mr Norris adds: "We found a lot of stocks in continental Europe that had high dividend yields and yet there didn't seem to be anybody offering an equity income product. Given that the European universe is much bigger than the UK we thought it presented a fantastic opportunity."

Targeting the retail market since December 2005, Argonaut's European equity income fund has so far attracted £430m in funds under management. Since inception, the fund, which is backed by parent company Resolution Asset Management, has returned 34.9 per cent, compared with a sector average of 31.4 per cent as at April 30 2008.

And as the fund approaches its all-important three-year milestone in terms of track record, it is starting to attract the interest of institutional investors.

While Argonaut is not interested in pursuing such investors, the arguments for

considering a European equity income fund should be compelling for pension funds and other institutional investors.

Meera Patel, senior analyst at Hargreaves Landsdown, supports Argonaut's view of the potential income stream from European stocks.

"Europe today compares favourably with the UK on many levels. The cash flows of European companies are currently better than any major region including the UK, US, Japan and Asia," she says.

In addition to the extra return opportunities, a European equity income fund provides much-needed portfolio diversification.

As sterling continues to weaken, European equities help reduce currency risk, while at the same time increasing exposure to new industry sectors and economic cycles.

Ms Patel says: "There are three times more companies in Europe than the UK with yields in excess of 3.5 per cent. The opportunities are therefore vast.

"Europe offers exposure to sectors not well represented in the UK, such as Norwegian oil services, and provides a choice of various economies at different stages of development."

Investing in global companies based in Europe also allows investors to capitalise on growth from the emerging markets, without the costs and risks associated with investing directly in develop-

ing countries.

Mr Norris says: "Investing in Europe has never been about investing in a sexy European economic growth story; it is about finding well-run global growth stocks at much cheaper valuations than on other exchanges around the world, and I am more bullish than at any time in the last two years."

In spite of these arguments, pension fund trustees are yet to give European equity income funds serious consideration. Chris Martin, director at Independent Trustee Services, says the vehicles have not been included as part of investment strategy discussions and until there is a three-year track record for investment consultants to analyse, this situation is unlikely to change.

Mr Russ identifies a second sticking point: "At the moment the problem is [the income fund] sits in the European alpha sector because it does not have its own sub-sector. This means competing against the alpha funds, which can be tough at times. We would like to see a proper sector develop so we could compare like with like, which would be more illuminating."

But with so few UK fund managers offering European equity income funds, Argonaut will have to wait until there are more players in the market before these are awarded a sector in their own right.