A new Jerusalem

Dividend increases and share buybacks are good news for UK equities according to our analysts - who think those dark Satanic mills could deliver world-beating total returns...

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What if the UK market isn't the forgotten backwater of global investing but instead the hidden realm where the next total return champions are quietly being forged? Picture an arena of dividends, buybacks, and capital growth, combining in a powerful alchemy, creating opportunities for those bold enough to seize them.

Sure, the UK is often labelled as a home to sluggish and out-of-favour industries, comprised of stocks that are overshadowed by the glittering tech titans across the Atlantic. But we think such labels fail to capture the dynamism simmering beneath the surface. Clinging to these perspectives risks overlooking a trove of undervalued and resilient opportunities, waiting for their moment to seize the gladiator's rudis—the ultimate recognition of victory in the total return arena.

In this article, we examine how shifting market dynamics are reshaping the UK as a playground for total return strategies. Most importantly, we also highlight the investment trusts that have proven themselves in the heat of battle—armed not with shields and swords, but with disciplined strategies, attractive income and share buyback profiles, and a keen eye for uncovering value in a market brimming with potential.

Time to shift perceptions?

It's no secret that UK valuations are languishing at historic lows relative to the US, with returns trailing far behind their transatlantic counterparts. This disparity has driven waves of capital outflows from the UK in recent years, as investors have chased the stellar performance of US tech giants. Simultaneously, we believe that many investors have also sought refuge in higher-yielding bonds and savings accounts amid elevated interest rates and economic uncertainty.

But history has shown, time and time again, that adversity often plants the seeds of opportunity for those willing to look beyond short-term market pessimism. One can't help but draw on Warren Buffett's timeless adage, *be fearful when others are greedy and be greedy only when others are fearful*. With UK equities overlooked and undervalued, could now be the time to embrace them?

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Catalysts of change

Beneath the surface lies a diverse tapestry of resilient businesses that are benefitting greatly from the UK's evolving dynamics. Many UK companies showcase strong fundamentals and a proven capacity to endure challenging macroeconomic conditions. We think that in many cases, not all, depressed valuations are less of a reflection of poor management or flawed business models but rather the result of prolonged economic headwinds.

One common critique of the UK market is its perceived lack of capital growth potential, even considering today's valuations. There's some truth to this, especially when comparing UK companies to their US equivalents. However, the tide may be turning. Key market fundamentals are showing improvements, as shown below, with stronger return on equity and reduced leverage, pointing to companies with greater profitability and healthier balance sheets. If this persists, the UK could be prime for a re-rating, as investors awaken to the long-term opportunities.

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Market Metrics: FTSE All-Share

	CURRENT ROE %	TEN-YEAR ROE AVERAGE	CURRENT NET DEBT/ EBITDA (X)	TEN-YEAR NET DEBT/EBITDA AVERAGE
FTSE All-Share	10.2	9.0	1.0	1.4

Source: Bloomberg, as of 15/01/2025

But here is where we think things get particularly compelling. The UK market is not only undervalued and showcasing improving fundamentals but it's also energised by transformative catalysts, which could unlock significant value without the need for a flood of new capital. One such catalyst is the heightened corporate takeover activity, fuelled by depressed valuations that have transformed UK companies into attractive acquisition targets for international buyers. In 2024 alone, British firms worth £145bn were acquired—over half involving foreign entities. By year-end, deal activity had jumped 21% compared to 2023, underscoring the growing recognition of the UK's undervalued potential. Many of these takeovers occurred at a premium to prevailing share prices, delivering, in some cases, substantial share price growth—a vital slice of the total return pie.

Building on this momentum, and chief among the catalysts, in our view, is the rise in buyback activity. Over the past year, nearly half of UK companies repurchased shares—the highest percentage among global markets. We think this is a clear signal that companies themselves recognise their undervaluation and are taking proactive steps to enhance shareholder returns. When executed at valuations below intrinsic value, buybacks can amplify shareholder returns, complementing the traditional income generated through dividends.

We think NatWest and Shell are prime examples. Over 2022 and 2023, NatWest repurchased approximately 10% of its shares whilst distributing dividends equivalent to about 12% of its market capitalisation. Shell, meanwhile, repurchased around 20% of its shares and paid dividends equivalent to roughly 10% of its market capitalisation. Together, these actions have delivered substantial value to shareholders in just two years—roughly 22% of market value for NatWest and 30% for Shell, or c. 11% and 15% annualised. Other players in the UK market, such as BP, Standard Chartered, and Barclays, echo this trend, embracing similar buyback and dividend strategies, helping support rising share prices in recent years. But for now, the two cases below help illustrate how buybacks and dividends can work harmoniously to deliver meaningful value to shareholders.

Together, these catalysts unveil a market rich with opportunity, and several UK-focussed investment trusts are already reaping the benefits by backing UK companies leading the charge on delivering shareholder returns. Take **CT UK High Income (CHI)**. Manager David Moss views the current environment as a pivotal moment for the banking sector as many are now generating low to mid-teen returns on equity and rewarding shareholders with growing dividends and buybacks. Growing conviction here has prompted him to build up notable positions in the likes of NatWest (3.7%) but also HSBC (6.6% at the time of writing), attracted by their robust dividend profiles, share buyback programmes, and strong market positions.

Similarly, the broader energy sector is proving its potential. Managers like Imran Sattar of **Edinburgh Investment Trust (EDIN)** and Ian Lance and Nick Purves of **Temple Bar (TMPL)**, note that whilst oil companies often face broader scrutiny, Shell is standing out for its evolving approach to the energy transition, as well as boasting a strong market position, attractive yield, and robust free cash flows. When combined with its disciplined capital allocation, which has driven high and growing returns to shareholders, these qualities have made Shell a key holding for both, with a 7.0% position in EDIN's portfolio and a 5.8% in TMPL's, as its current shareholder-focussed strategy and growth prospects align with their total return ethos.

Champions of the total return arena

Investment trusts, as listed companies themselves, face many of the same pressures, challenges, and tailwinds as the businesses they invest in. When they buy back their own shares, the accretion to NAV is very easy to calculate (much more so than is the case with operating companies), adding another dimension to the measurable cash return to shareholders. Below we show how many shares have been bought back by each trust in the AIC UK equity income sector over the past three years (to 10/01/2025). We also show the percentage of market cap bought back.

Returns To Shareholders

UK COMPANY	TWO-YEAR DIVIDEND PAID (EX-SPECIAL) (%)	TWO-YEAR SHARE BUYBACK RETURN (%)	TWO-YEAR CASH SHAREHOLDER YIELD (%)
NatWest	12.3	10.1	22.4
Shell	10.0	19.7	29.7

Source: NatWest and Shell latest annual report 2023, Kepler calculations (two-year period covering 2022 & 2023).

AIC UK Equity Income Sector: Buyback Return

UK EQUITY INCOME TRUSTS	TOTAL SHARE BUYBACKS (IN £)	THREE-YEAR BUYBACK RETURN (AS A % OF MARKET CAP)
FGT	518,074,060	25.8
EDIN	132,232,272	12.1
TMPL	75,097,811	9.7
BRIG	2,524,076	6.1
JCH	27,209,686	6
MUT	37,771,499	3.6
SHRS	2,579,981	3.1
LOW	7,321,020	2.0
CTY	8,478,035	0.5
CTUK	1,476,000	0.4
DIG	526,833	0.1
SCF	123,526	0.1
LWDB	212,875	0.0
AEI	N/A	0.0
CHI/CHIB	N/A	0.0
DIVI	N/A	0.0

Source: Morningstar, Kepler calculations (data range 10/01/2022 to 10/01/2025). N/A – trusts that didn't initiate a share repurchase over the period (share redemption and additional listing corporate action types have been excluded).

Below we take it a step further by annualising each trust's buyback return over three years and combining it with their historic dividend yields to give a rough idea of the potential total cash return on offer. This reveals several trusts putting forward a strong case to be considered total return champions. We stress that this approach isn't a precise calculation—due to market variables and the fact that trust boards may alter their policies moving forward—but we think it provides a useful indication of which trusts, relative to their size, offer the highest all-in cash "yield", or total cash return as we refer to it below.

Returns To Shareholder

UK EQUITY INCOME TRUSTS	ANNUALISED THREE-YEAR BUYBACK RETURN (%)	HISTORICAL YIELD (%)	TOTAL CASH RETURN (%)
FGT	8.0	2.2	10.2
EDIN	3.9	3.7	7.6
SHRS	1.0	6.0	7.0
JCH	1.9	5.0	6.9
TMPL	3.1	3.5	6.6
MUT	1.2	4.7	5.9
LOW	0.7	5.1	5.8
CTY	0.2	4.8	5.0
BRIG	2.0	2.5	4.5
CTUK	0.1	3.9	4.0

Source: Morningstar, as of 10/01/2025

Finsbury Growth & Income (FGT) – amplifying shareholder returns

FGT stands out in the UK equity income sector for its focus on quality growth companies and a concentrated portfolio of just 23 holdings. Its 8.0% annualised three-year buyback return leads the group, complementing a lower dividend yield of 2.2% to deliver a total cash return, based on our rough calculations, of 10.2%—the highest among peers. This high buyback return reflects FGT's commitment to its discount control mechanism, which aims to ensure shares trade within a range of a 5% discount to a modest 2% premium. Combined with the defensive and compounding nature of its portfolio, FGT offers investors a compelling mix of capital growth and incremental shareholder value.

Edinburgh Investment Trust (EDIN) – quality focus, steady returns

Based on our workings, EDIN's total cash return of 7.6% reflects a 3.7% historical yield and 3.9% annualised buyback return. Whilst its yield is more modest compared to some peers, EDIN has built a steady track record of reliable income and capital growth, alongside a strong commitment to share buybacks. Under the leadership of Imran Sattar, the trust focusses on high-quality, cash-generative companies with strong growth potential and competitive advantages, positioning it for both income generation and long-term capital appreciation.

Despite trading at a higher price-to-earnings (P/E) ratio than the index, the emphasis Imran places on profitability and growth prospects supports its superior long-term performance potential. Additionally, the focus on companies with lower debt also provides added resilience in times of market stress, helping the trust navigate challenging periods, including rising interest rates, with greater financial stability. Combining robust dividend growth and an attractive buyback strategy, EDIN remains a reliable option for income and growth-focussed investors.

Shires Income (SHRS) – punching above its weight

Despite being smaller in size compared to some of its peers, with a market cap of around £127m, SHRS has consistently returned value to shareholders through buybacks, annualising 1.0% over the past three years, according to our rough indications, on top of its already generous 6.0% historical yield. Additionally, we also think SHRS's high, yet growing dividend, benefits from its unique income strategy. The trust's allocation to

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preference shares offers stability and predictability to its yield, whilst its ability to invest in small- and mid-cap businesses strikes a strong balance between current income and future growth potential. SHRS's inclusion on the AIC Dividend Hero list further reinforces its commitment to consistent income, distinguishing it as a reliable option for income-focussed investors.

JPMorgan Claverhouse (JCH) - all-cap income in action

JCH takes a more income-focussed approach than some peers in the sector. It has consistently returned value to shareholders through buybacks, annualising 1.9% over the past three years, on top of its already generous 5.0% historical yield, one of the highest in the group. The change in the management team has introduced a refreshed strategy, embracing a "genuinely all-cap approach" and rethinking income exposure by diversifying into mid-cap companies with strong dividend growth prospects and a three-bucket yield strategy which prioritises income stability and growth. Moreover, JCH boasts a 51-year dividend growth track record and significant reserves, which we argue places JCH as a strong option for both reliable income and consistent growth potential.

Temple Bar (TMPL) – focussed value delivery

TMPL's disciplined value investing approach prioritises businesses offering attractive valuations, strong cash generation, and sustainable dividend growth, a combination which helps the portfolio deliver both resilience and upside potential, even in challenging market environments. TMPL's total cash return of 6.6% reflects this disciplined approach, balancing a solid historical yield of 3.5% with a 3.1% annualised buyback return. TMPL's managers are advocates of the power of total returns, consistently highlighting the importance that both buybacks and dividends can have to shareholder returns over time.

Over the last three years, the board has shown a clear commitment to returning value to shareholders and putting its strategy into action. Whilst its dividend yield is lower than some peers, TMPL's focus on undervalued opportunities with strong recovery potential, alongside its commitment to added additional returns through buybacks, remains a core attraction for long-term investors, further enhancing its appeal, in our view.

What about smaller companies?

We've focussed much of our attention on trusts that invest predominately in larger companies. However, when it comes to smaller companies, we think they often fly under the radar. Some investors might assume that smaller companies sacrifice income potential for capital growth potential—or vice versa. Whilst this can be true for some, many smaller businesses offer the best of both worlds: strong, rising income alongside impressive capital growth.

Trusts that specialise in smaller companies recognise this potential, offering investors a differentiated source of total returns not often seen in large-cap stocks. **Aberforth Smaller Companies (ASL)** is a prime example. Although ASL does not explicitly target income, it has consistently demonstrated its ability to provide a solid yield of 3.0%, with annualised dividend growth of 7.4% since inception. This growth has outpaced inflation (2.5%) and surpassed both small-cap and broader market indices. Additionally, ASL has returned value to shareholders through share buybacks, annualising 1.0% over the past three years, bringing its total cash return to 3.9%.

In the first half of 2024, fourteen of ASL's holdings repurchased shares, with boards taking advantage of depressed stock market valuations. This activity highlights the catalysts we discussed earlier are prevalent across the UK market-cap spectrum.

ASL's commitment to buybacks and conservative approach to income management, supported by significant revenue reserves, strengthens its ability to sustain and grow its dividend. In addition to its regular dividend, ASL has also paid special dividends, though these are not guaranteed. Overall, its blend of value-driven capital growth, a rising income stream, and buyback activity underscore it as a compelling option for those looking for UK smaller company exposure, with strong total return potential.

Conclusion

The UK market, long overlooked and undervalued, is positioning itself as an unexpected powerhouse for shareholder returns. Beneath its seemingly stagnant surface, a battle of transformative catalysts—corporate takeovers, rising buybacks, and resilient businesses—is quietly reshaping the landscape. These dynamics are forging a new breed of total return champions for those willing to look beyond short-term pessimism.

The synergy between buybacks and dividends presents a potent formula for total returns, uniquely suited to the UK's current valuation landscape. Buybacks not only signal management's confidence in undervalued businesses but also enhance shareholder value by reducing share count and increasing earnings per share, delivering welcome additional returns in today's current environment. We should acknowledge here, that the economics of buybacks are not quite the same for trusts as for commercial companies. Shell will generally not be selling oil fields to buy back shares, but one way or another, an equity income trust will be selling equities to buy back shares. This means the compound effect on EPS over time is much higher for a

commercial company. That said, trust buybacks do boost NAV per share and have some positive effect on EPS too. Considering these payments and robust dividend payouts, we think investors are well-placed to benefit from both the immediate income and amplified long-term gains the UK has to offer.

UK-focussed investment trusts are capitalising on these evolving dynamics and harnessing their structures and expertise to deliver tangible results for investors, in our view. For those with a long-term perspective, the UK's once-overlooked market is poised for transformation — potentially as a coliseum ready to crown the next generation of total return champions.

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