Hairbrained scheme

How investment trusts can provide a madcap level of income diversification...

Update
16 April 2025

Analysts:

Ryan Lightfoot-Aminoff
Ryan@keplerpartners.com

Following a vote in 1994, the UK public chose the widget inside a can of Guinness as Invention of the Year. In second place, was the internet. Whilst both inventions have had an impact in their own way – Guinness has recently claimed the number one spot as the country's most popular beer – it's probably safe to say the internet has generated more change to society in the 20-plus years since the vote, despite being usurped by a widget at the time. This rather circuitously brings us onto the topic of this week's article, income portfolios. Historically, income funds have been populated with a mixture of government and corporate bonds, equity income and occasionally some real assets such as property or infrastructure.

Allocations between these asset classes often vary, depending on underlying macro conditions, as can the allocations within each asset class to different subsectors and industries, although they have primarily stayed within a small traditional subset. However, over the past few years, one interesting theme in the investment trust space has been the growing prevalence of enhanced dividend models. Typically, this involves using a contribution from the capital returns of a portfolio to pay out a fixed amount of income. Furthermore, trusts have the ability to hold back revenue in the good times to support the dividend in more challenging periods, enabling a smoother, more predictable income and growth trajectory. As such, the choices available to investors in the equity element of an income portfolio are higher than ever before, offering a much wider pool of potential asset classes to choose from whilst still generating an attractive income. To explore some of the more intriguing choices, we have put our own inventor hats on to devise a prospective income portfolio of more esoteric trusts, covering a range of asset classes and geographies that a more traditional approach may overlook to arrive at what we call our Madcap Income portfolio.

Unpopularity contest

We start off our search close to home. The UK is quite popular for equity income investors due to a relatively higher proportion of more traditional dividend-paying sectors, such as banks and oil majors. However, these are usually large-cap companies, meaning smaller companies are often overlooked in the quest for income. Small-cap companies are not usually a major feature of income-orientated portfolios altogether, as they traditionally use any additional capital to fund future growth, rather than pay out to shareholders as dividends. This also means income portfolios are usually more value biased.

Therefore, by adding in growthier areas, such as small-caps, it not only brings a whole new area of the market into play, but can help an income portfolio with style diversification. Fortunately, there are a number of UK smaller companies trusts with enhanced dividend policies that can offer both growth potential and a good income for investors. One of these is **JPMorgan UK Small Cap Growth & Income (JUGI)**. Managed by Georgina Brittain and Katen Patel, the trust recently adopted a new dividend policy. In early 2024, the board announced a dividend equivalent to 4% of the end of financial year NAV, to be paid out in quarterly instalments across the following year. With a current discount of c. 12%, this means the portfolio of small- and mid-cap stocks offers a historic yield of c. 5.4%, as at 14/04/2025 , meaning both an attractive income and growth potential. An honourable mention goes to the newly named **Artemis UK Future Leaders (AFL)**. Formerly known as Invesco Perpetual UK Smaller Companies, the trust is under new management, although the enhanced dividend policy remains in place which currently offers a dividend yield of 5.1%.

Moving across the Channel, European smaller companies could offer further diversification benefits. Europe is less renowned than the UK for its income offering. However, the smaller companies sector offers huge geographic diversity, ranging from the Nordics to the Iberian Peninsula. One trust capturing this is **European Assets (EAT)**. Manager Mine Tezgul takes a broadly diversified approach, enabling her to capture the wider range of opportunities in the market, from energy transition, to digitisation and deglobalisation, also with a recent focus on European defence names. The trust pays an enhanced dividend of 6%, based on the closing NAV of the financial year, which is paid out quarterly in the following financial year. EAT is also trading at a discount at present, meaning the potential entry yield investors could get is higher. The dividend policy means Mine is free to invest in the best opportunities she can identify from across the continent, without being bound by any income demand, and therefore the trust is a worthy addition to our Madcap Income portfolio .

Our final smaller companies constituent is **abrdn Asia Focus (AAS)**. Managed by a three-strong team of Flavia Cheong, Gabriel Sacks, and Xin-Yao Ng, AAS owns a relatively concentrated portfolio of smaller companies but diversified from across the many countries in the Asian region, including the likes of Thailand, Indonesia and Taiwan. Strictly speaking, the trust doesn't belong in this portfolio as there is no enhanced dividend, but we do think it is a good example of how the investment trust sector can offer a decent dividend from a low-yielding growth sector. The board changed the dividend policy in 2021 to pay a moderate and growing dividend. Since the new policy, all dividends have been covered by revenues, though there is close to 1.5× the previous annual dividend in revenue reserves to be called on if required. The trust has also got an impressive track record of paying special dividends, having done so in nine of the past ten financial years. This natural income approach means the historic yield of c. 2.7%, including specials, is slightly lower than other trusts we have considered, although the progressive approach and attractiveness of the asset class means we believe it warrants a place in our portfolio.

Sticking with Asia, we have also included **JPMorgan China Growth & Income (JCGI)**. We believe this adds further differentiation, as China is quite a low weight in the Asia smaller companies index (c. 13.3% as at 31/03/2025), but is still a powerful economy, both regionally and internationally. JCGI's managers, Rebecca Jiang and Li Tan are growth-orientated, meaning the portfolio has a notable overweight to technology, whilst also being underweight financials, both differentiated allocations to a traditional income-seeking portfolio. Their dividend approach is similar to JUGI, paying 4% of the NAV on the last business day of the preceding financial year. The current discount, and the volatility present in markets at time of writing, means this offers a historic yield of c. 5%.

Our final Asian consideration is Japan. Higher dividends have been an area of focus as part of the country's corporate governance reform push. A number of trusts have been looking to capitalise on this, including **CC Japan Income & Growth (CCJI)**, which has increased its dividend every year since inception in 2015 and makes for a worthy candidate for inclusion in an alternative income portfolio . We would also highlight **Schroder Japan (SJG)** due to its recent adoption of an enhanced dividend, which will see it pay out 4% of NAV, from a combination of the underlying income, which is approximately half of this level, and capital. This slightly higher yield just gave it the edge in our Madcap Income portfolio.

One geography we haven't yet explored is North America. The region is rarely a consideration when compiling income portfolios due to the low dividend culture, which instead prioritises share buybacks. The strong tech company bias, which often use spare cash to innovate is also a contributing factor. However, a new strategy at **BlackRock American Income (BRAI)** may offer investors something here. As part of a series of reforms **announced in March 2025**, the trust has proposed a dividend of 1.5% of NAV per quarter, equivalent to 6% a year, far in excess of the index. Furthermore, the trust has also adopted a value-orientated approach, which could help mitigate some of the growth focus elsewhere in the portfolio.

Our final two choices are even more outlandish. We have identified two trusts that have truly capitalised on the investment trust structure to create an income stream from asset classes rarely associated with them. Firstly, there is **International Biotechnology (IBT)**. Despite being invested in the growth-focussed biotech sector, and having a bias towards small- and mid-caps, the trust currently yields in excess of 5%, thanks to an enhanced dividend and current wide discount. Adding this asset class to the portfolio brings with it considerable capital upside potential.

Finally, there is **CT Private Equity (CTPE)**, one of a number of private equity trusts we could have selected. CTPE has a fairly mainstream approach, blending third-party fund commitments with co-investments, though the focus on lower mid-market companies means considerable potential for upside. The trust also has a formulaic dividend policy, which ensures dividends will be the equivalent of 4% of NAV per annum, recalculated on a quarterly basis. However, if in any quarter this figure implies a reduction in the dividend, the quarterly dividend payable will be maintained. This has enabled dividends to compound at c. 10% per annum over the past ten years, offering a good yield and the potential for future growth.

Portfolio analysis

Combining all of these together into an equally weighted portfolio, we can see how this group of trusts compares to a global index and what insights this could offer. Firstly, looking at the yield, we can see the overall portfolio offers a yield of c. 4.97%, vastly above that of the MSCI World Index of 1.93% and still considerably more than the MSCI World High Dividend Yield Index at 3.47%, though we should caution some of these figures may vary as a result of the tariff-induced volatility as at time of writing.

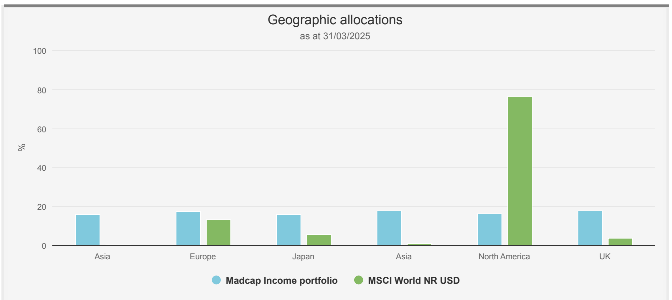
MADCAP Income Portfolio Characteristics

TRUST	STYLE	Yield (%)	Discount (%)
CT Private Equity	N/A	6.29	-34.92
European Assets	Mid-cap growth	7.23	-11.53
International Biotechnology	Small-cap growth	5.63	-17.41
JPMorgan China Growth & Income	Large-cap core	5.18	-14.67
JPMorgan UK Small Cap Growth & Income	Small-cap core	3.76	-12.13
Schroder Japan	Large-cap core	4.97	-11.16
abrdn Asia Focus	Small-cap growth	2.42	-13.82
BlackRock American Income	Large-cap value	4.26	-10.74
Average		**4.97**	**-15.8**

Source: Morningstar & AIC (dividend yields) both as at 10/04/2025. NB. Yield calculation methodologies may vary

One major factor behind our Madcap Income portfolio's higher yield is likely to be the US allocation, which is, as discussed, not a traditional income market. This is where our portfolio has significant differences to both global indices, even the dividend-focussed one. Despite the recent turmoil, the US remains an economic powerhouse, and is host to the world's leading companies. However, few of the companies here offer attractive income returns. As such, we have looked to offer equal exposure to a range of different geographies, meaning a broad geographic spread for a potential income portfolio. When compared to a global index, it has come up very US-light, although with the slight caveat that CTPE does have some underlying US exposure but has not been included in these allocations as it is not produced by Morningstar due to the private nature of the portfolio. Moreover, these allocations only account for company listing, and will therefore not account for revenue generation, which is arguably a better determinant of economic exposure. Regardless, the North American weight for the portfolio of c. 16% is significantly lower than the High Dividend Index at 58.1%, and even more so versus the wider global index at 76.5%, as we have shown in the chart below, and this will have a significant impact on the relative return profile.

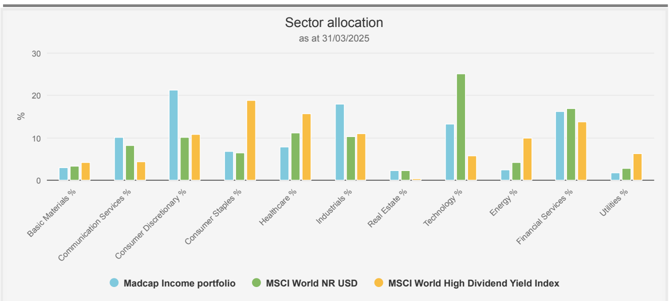
Fig.1: Country Allocations



Source: Morningstar

One of the key reasons behind the US's low income output is the high proportion of tech companies. Traditionally, the tech industry has used excess capital to fund R&D and capture future growth. As a result, tech companies are usually a very low weight in income indices, as can been seen in the chart below, with a low allocation for technology in the dividend index. However, our portfolio is actually slightly overweight the industry versus this index, albeit still below the global index, which helps mitigate some of this risk, and is likely a reflection of the growth biases these trusts have due to the enhanced dividend approach. Of course, investors could easily overweight this sector in an income portfolio simply by not equal weighting each constituent, as we have.

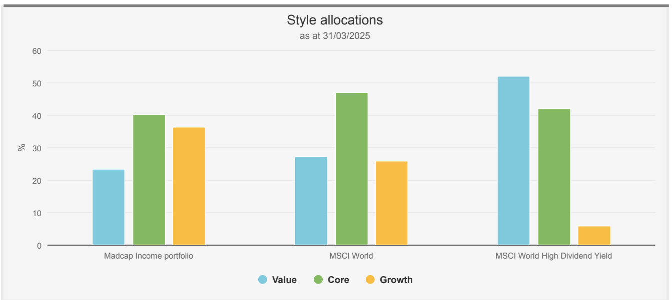
Fig.2: Sector Allocations



Source: Morningstar

This leads us onto our final comparison, style balance. Equity income portfolios are typically more value biased, as a result of the industry allocations already mentioned, but also due to the fact that companies often offer higher yield as a function of their lower valuations. This can be seen in the strong bias to value stocks in the high dividend index, with over half allocated to the style, and only c. 6% in growth stocks. However, this is where our Madcap Income portfolio stands out, with allocations to growth above that of even the MSCI World Index at 36.4% versus 25.7%. This is arguably the key beneficiary of incorporating enhanced income strategies into an income portfolio. Many of the strategies we have highlighted have a strong growth focus whilst still offering high yields and therefore, by incorporating them into a portfolio, it offers critical diversification benefits compared to what income investors may otherwise achieve.

Fig.3: Style Allocations



Source: Morningstar

Conclusion

Investment trusts offer an incredible variety of options to equity income investors. In recent years, the growth in enhanced dividend policies has greatly increased the opportunity set, although there are also plenty of trusts offering a natural income from sectors where income investors rarely rake exposure. To illustrate this, we have constructed a broad income portfolio offering a higher income than the wider market. Of course, we don’t think investors are likely to be best served by equal weighting these trusts, but the exercise does show the flexibility and potential at hand. And needless to say, there are a number of other options we didn’t select. One of the key lessons of the exercise is that investors can still capture growth exposure, with a substantial allocation to the structural tailwinds of technology, whilst generating an attractive portfolio income. Interestingly, our Madcap Income portfolio has also produced a considerable underweight to the US. Considering the current market backdrop in the wake of the tariff-induced market volatility, this could be an intriguing direction for those concerned over the changing outlook for the country and its dominance of global equity indices.

Disclaimer

Past performance is not a reliable indicator of future results. The value of investments can fall as well as rise and you may get back less than you invested when you decide to sell your investments. It is strongly recommended that if you are a private investor independent financial advice should be taken before making any investment or financial decision.

Kepler Partners is not authorised to make recommendations to retail clients. This report has been issued by Kepler Partners LLP, is based on factual information only, is solely for information purposes only and any views contained in it must not be construed as investment or tax advice or a recommendation to buy, sell or take any action in relation to any investment.

The information provided on this website is not intended for distribution to, or use by, any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulation or which would subject Kepler Partners LLP to any registration requirement within such jurisdiction or country. In particular, this website is exclusively for non-US Persons. Persons who access this information are required to inform themselves and to comply with any such restrictions.

The information contained in this website is not intended to constitute, and should not be construed as, investment advice. No representation or warranty, express or implied, is given by any person as to the accuracy or completeness of the information and no responsibility or liability is accepted for the accuracy or sufficiency of any of the information, for any errors, omissions or misstatements, negligent or otherwise. Any views and opinions, whilst given in good faith, are subject to change without notice.

This is not an official confirmation of terms and is not a recommendation, offer or solicitation to buy or sell or take any action in relation to any investment mentioned herein. Any prices or quotations contained herein are indicative only.

Kepler Partners LLP (including its partners, employees and representatives) or a connected person may have positions in or options on the securities detailed in this report, and may buy, sell or offer to purchase or sell such securities from time to time, but will at all times be subject to restrictions imposed by the firm's internal rules. A copy of the firm's Conflict of Interest policy is available on request.

PLEASE SEE ALSO OUR TERMS AND CONDITIONS

Kepler Partners LLP is authorised and regulated by the Financial Conduct Authority (FRN 480590), registered in England and Wales at 70 Conduit Street, London W1S 2GF with registered number OC334771.