Alliance Trust: more than meets the eye

Due to the high alpha approach, capital appreciation often gains the headlines, however ATST is also one of the most dependable income sources in the investment trust universe...

Update
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Alliance Trust (ATST) is one of the largest trusts in the investment companies universe, sitting in the FTSE 250 with gross assets of around £3bn.

The management of the fund was changed in April 2017 from an in-house investment team to an externally managed multi-manager approach. Willis Towers Watson (WTW) were appointed to oversee it, with the investment committee, led by Craig Baker, selecting the external managers for different parts of the underlying portfolio. WTW gives the managers mandates, with few restrictions, and each has the aim of creating a 'best ideas' portfolio of between 10 and 20 stocks from anywhere in the world. Through this approach, the team hope that can generate the levels of alpha associated with concentrated portfolios, without the risk profile of a single portfolio. WTW actively manages the allocations between managers to ensure that performance is primarily driven by stock selection, rather than by sector, style or country weightings.

Due to the high alpha approach of the team at WTW, capital appreciation, rather than income, often gains the most attention. However, there is more to ATST in terms of income than initially meets the eye.

Dependable income, with a record to prove it...

Throughout 2020 we have seen a 'dividend drought', with income seekers coming under a great deal of pressure due to the impact of COVID-19. According to the most recent Janus Henderson Global Dividend Index, which measures the income of 1,200 global firms, Q2 this year saw a 22% drop in dividends. Within Europe 54% companies reduced their pay-outs, of which two thirds cancelled them. Banks, which were asked to favour emergency loans over paying dividends, accounted for 50% of the decline.

In this environment, a safe haven for income investors has become an obvious priority. The investment trust structure has particular advantages in this regard – the ability to pay income from the capital account, and the ability to build income 'reserves' to shore up their dividends on a 'rainy day' among them. Alliance Trust is a good example of these advantages in practice. The trust has one of the most impressive dividend track records in the entire investment trust universe, increasing it progressively for the last 53 years. Over the past five years, this has come at a rate of more than 7% (source: JPMorgan Cazenove). The most recent full-year dividend (2019) equated to 13.96p per share, an increase of 3% over the 2018 dividend. Although ATST's shares yield only 1.7%, this compares favorably to the rest of the AIC Global sector, where the weighted average yield is 1.1% (JPM Cazenove).

When Kepler spoke to the team, they said that a 54th year of dividend increases is highly probable and a key reason for this is the support offered by the revenue reserves. Unlike open ended funds, investment trusts can retain up to 15% of the revenue they receive from their underlying investments in a reserve. Over time, this can be built up and, should there be a cut in the income of the underlying companies, the board can utilise their reserves to maintain dividends the trust pays. The most recent full year dividend from ATST was covered 2.35x by revenue reserves and, to further strengthen this, the board have also announced their intention to convert their merger reserve to a distributable reserve. Assuming the board's plan is approved by shareholders and the courts, this means that there would be an additional £645.3m available to support increased dividend levels in the future.

Alongside this, the board have also introduced a 'Dividend Reinvestment Plan' for investors themselves. This has been available since the June 2020 dividend and brings with it a number of benefits. It is a considerably more cost-effective way of investing, due to the lack of brokerage costs. Alongside this, there are significant compounding benefits. If one compares the total return of the MSCI ACWI (a comparative global index) to the price return, investors have seen returns 17.98% greater due to the reinvestment of dividends.

As this is a multi-manager strategy, the job of choosing where to invest is taken away from the investor, and given to professional fund selectors with access to the skills, resources and knowledge of some of the best investment houses in the world – giving the trust particular appeal to those who prefer not to get involved in the mechanics of portfolio construction themselves.

This, combined with the factors we have discussed in this article, means ATST is an interesting option for investors searching for an 'all-in-one' solution offering exposure to the stock market which can deliver not just capital appreciation, but a reliable income too.

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