

Excerpted from

MAY 2010

# CHARITYFINANCE

[www.civilsociety.co.uk/finance](http://www.civilsociety.co.uk/finance)

The authority on charity finance and law

## Upwardly mobile

Charity IT Survey reveals  
surge in mobile working



IT SURVEY 2010

# Investment income

## High yielding equities present a great opportunity for income-hungry charities, says **Angela Lascelles**.

MARCH HAS HISTORICALLY been a significant month for equity investors – a month of fear and opportunity and a month when correct decisions for long-term charity investors can reap substantial long-term rewards for trustees.

‘Wednesday in Cheltenham week’ has often been the turning point. The winning bet on the senior race could give a handsome return by gambling, but on the same day shrewd investors could take sensible decisions to invest in cash flows which meet their objectives, based on fundamental analysis of the economy and of companies operating within it. This was certainly the case in March 2003, when equity yields equalled gilt yields, the economy was growing and so were dividends. Fear of war was affecting markets and providing opportunities for charities to invest very cheaply in equities. Equities then yielded 4 per cent and long gilt yields were 4.5 per cent. In that year the opportunity to secure a high and growing income flow from equities disappeared swiftly and in the nine months to the end of 2003, the FTSE All Share Index rose by 24 per cent.

Wind the clock forward by six years to 2009, and the same opportunity arrived again, though in rather different and somewhat more precarious circumstances. Wednesday in Cheltenham week again and the market was on its knees, worn down by the collapse of banks across the globe, economic activity in a state of shocked paralysis and huge over-borrowing by consumers, companies and governments alike. Pension funding had been destroyed and the fundamentals were more adverse

than previously experienced by any investment professional.

But spring was in the air. Governments had responded to the crisis with a combination of quantitative easing and base rate down to 0.5 per cent. Gilt yields were 3 per cent at the ten-year maturity and equities were yielding well over 5 per cent. Cash at the bank yielded very little if anything. Dividends had all but disappeared in the financial sector but still the equity market overall was giving a substantial premium yield over gilts for the first time since the late 1950s. Confidence returned to a few brave investors, and the momentum grew through the rest of the year, with an uplift from 31 March to the end of 2009 of 39 per cent in the All Share Index.

Within the overall market recovery, the higher yielding and more defensive areas of quoted companies underperformed dramatically. The FTSE All Share Index hit its all-time-high level on 15 June 2007 with a closing level of 3,499 and a yield of 2.7 per cent. The High Yield Index (the 175 higher yielding companies of the largest 350 quoted companies) on the same day was 4,182 with a yield of 3.6 per cent. From that day to the end of March this year, the All Share Index had fallen by 16.4 per cent but the High Yield Index was 27.5 per cent lower over the same period, an underperformance of 11 percentage points. These companies include the oil, pharmaceutical and utility sectors, which are those considered to be the most defensive areas of economic activity. Why they were re-rated comparatively

modestly is a mystery, but then many market movements in these days of geared investment vehicles, short trading positions and computer generated investment decisions are a mystery.

In economic conditions of steep recession and then weak recovery, the defensive and high-yielding parts of the equity market would logically have outperformed, but the reverse has happened and created a great opportunity for income-hungry charities. Dividends are now growing again, and in the first quarter of 2010 rose by 7 per cent. Companies in the high-yield part of the market not only give you a high starting yield, but now on average are expected to grow.

Today the UK equity market overall has, we believe, reached a valuation which is a fair reflection of the recovering earnings on the one hand, and the need to reduce the fiscal deficit on the other. The yield on the All Share Index is now 3.2 per cent and the yield on ten year gilts is just over 4 per cent. The opportunity to obtain a high and growing income stream from the High Yield Index, however, is still there with a yield of 4.8 per cent. There are a few Common Investment Funds available for charities to invest in this part of the equity market, with yields of more than 4 per cent. There is thus an opportunity for charity investors to secure an income at least as high as gilts and which is expected to grow over time. ■



**Angela Lascelles**  
is a managing  
director of OLIM  
which advises the  
Charity Value and  
Income Fund