Income Watch

Multi-Manager Navigator Distribution fund income update

Edition 18 – September 2021

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Since COVID-19, income payments have been under intense scrutiny and pressure from a number of angles. Given the importance of income to many of our clients, and its role as a key driver of total returns for all investors, we are regularly sharing our observations and relevant factual information with you.

Executive Summary – September 2021*

- Fund is no. 1 for income since launch
- The fund will be paying its annual bonus for the monthly M income units at the end of September.
- For the fund's last financial year to 31st August 2021, income fell by just under 16%. We believe that we are past the bottom now and starting to grow again as witnessed by all the major surveys on equity income.
- The latest Janus Henderson survey reported Q2 dividends were up 11.2% on an underlying basis globally. Please see page 4 for further details.
- Strong recovery in the Distribution fund's total return performance from March 2020 lows continues. Relative performance was good again in August.

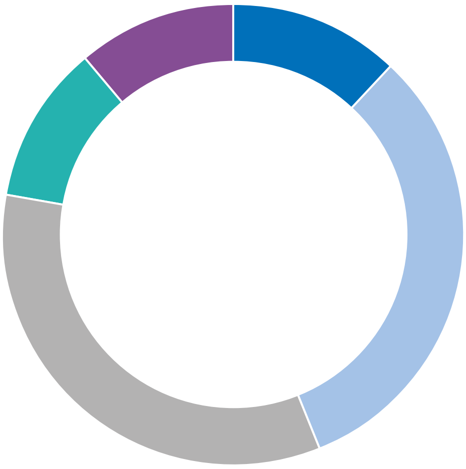
*Source for all data referred to is LIM, periods to 31-Aug-21

Key risks

The value of investments and any income from them can go down as well as up and investors may not get back the original amount invested.

The information, opinions, estimates or forecasts contained in this document were obtained from sources reasonably believed to be reliable and are subject to change at any time.

How your fund and its income is made up:
What makes up the yield of the Distribution portfolio?



Asset class	% of Income
UK equities	12%
Cash	0%
Overseas equities	32%
Bonds	34%
Property	11%
Specialist	11%

A Truly Diversified Income Portfolio comprised of:

- **32** fund holdings,
- From **26** providers
- Covering **5** major asset classes and more than 10 different underlying areas
- With over **2,000** underlying sources of income!

Comment on each major asset class:

1. **Equities (makes up 42% of the overall portfolio yield)** – we expect a mild improvement in income from equities as economies re-open, regulatory restrictions on dividends ease and boardroom confidence in the outlook improves.

2. **Bonds (makes up 34% of the overall portfolio yield)** – we expect a stable outlook from the bond portfolios as strategic funds use their broad brief to avoid duration issues that will hit corporate and government bond funds should they materialise.

3. **Property (makes up 13% of the overall portfolio yield)** – our selection of less economically sensitive assets, many with upward rent review potential, give us optimism for a gently improving income from this section of the portfolio. We have also seen Darwin Leisure Property recommence paying dividends on a quarterly basis; as our largest property holding this represents a notable boost to the overall portfolio income.

4. **Specialist (makes up 11% of the overall portfolio yield)** – the mix of care homes, music royalties and infrastructure equity should give stable to improving income from here.

5. **Cash (makes up 0% of the overall portfolio yield)** – we expect to continue to run very low cash balances whilst interest rates are close to zero, and if we need to protect the fund against short term volatility will try to do so using futures.

Continued

Looking back, a review of income changes during the year of COVID-19 – Mar-20 to Aug-21.

In total we have seen	157	dividends declared in the fund holdings since March 2020
Of these dividends:	57	have increased year on year
	74	have decreased year on year
	26	are unchanged year on year
If you're 'glass half full':	53%	of all dividends declared are flat or higher year on year
If you're more 'glass half empty':	64%	of all dividends declared are flat or down year on year
Of the dividends that increased YoY,	29%	was the average rate of increase
Of the dividends that decreased YoY,	-25%	was the average rate of decrease

Source: BMO Global Asset Management as at 31-Aug-21

Looking ahead what is the income outlook?

Equity Dividend Outlook:
Industry Surveys – latest news and views

Surveys: Janus Henderson Q2 2021 – Report on Global Dividends to end Q2 2021

Summary:

- Strong dividend recovery seen in Q2 2021 with headline growth of 26.3%. This was boosted by a large number of special dividends with underlying growth at 11.2%
- Dividends from companies re-starting payments made up three quarters of the underlying growth figure
- 84% of companies saw dividends unchanged or increased
- The JH Dividend Index is now **7%** below its March 2020 peak
- Q2 is the key dividend quarter in Europe – dividends were up 66.4% on a headline basis, and 20.1% on an underlying basis
- UK underlying growth of 42.2% was predominately as a result of dividends being restarted
- Sector wise, mining led the rebound, with 69% underlying growth – this took payouts above their pre-pandemic level

Janus Henderson see the recovery so far as stronger than they expected; they upgrade their 2021 forecast to $1.39 trillion, which would be just 3%.

Surveys: Link Asset Services Q2 2021 – UK Equity dividends forecast improved the worst case scenario, but trimmed the best case for a range of between +0.9 to +5.6% in 2021.

Their quarterly survey focusses on dividends in the UK only.

- Q2 dividends were up 51% to £25.7bn
- Excluding special dividends, growth was 43.8% to £24.3bn. This is around 17% below the level of dividends seen in Q2 2019 (i.e. pre-pandemic)
- Close to 90% of the increase in Q2 came from companies that had cancelled dividends in Q2 2020
- Almost every sector saw payouts rise year-on-year. Banks and mining led the way, accounting for over two thirds of the increase
- The mid 250 was hit hardest by the pandemic and is as such seeing the strongest bounds – dividends were up 156% Y/Y in Q2. FTSE100 dividends were up 44.4%
- They upgrade their outlook for 2021 thanks to the removal on constraints on banking dividends
- They expect £79.5bn of dividends in 2021, an increase of 24.4% on 2020, but still down 29.2% on 2019 when dividends totalled £112.3bn
- Surveys: AJ Bell June 2021 – Their survey, using data to the end of February reported an expected 25% increase in dividends (up from 19% last time) for the FTSE 100 index in 2021 with £76.9bn of payments – enough for a dividend yield of 3.7%. They also expect dividend cover to improve from 1.4x in 2020 to 1.83x in 2021.
- Growth for 2021 is expected to be 10.7% on a headline basis, with underlying growth of 8.5%

Equity Dividend Outlook:
Regulatory position – what is the backdrop?

Regulatory Aspects: Banks no longer restricted – During February 2021 Britain's largest banks were permitted to resume dividends after a year's pause, after the PRA removed its overall veto in December. However, the Bank of England retained what termed 'guardrails' restricting dividends to around 25% for the banks. All such restrictions were removed in early July.

Regulatory Aspects: IA enforcement of the tests will be reintroduced. The annual 90% yield hurdle test will be applied as it was before the moratorium. However, the three-year rolling average yield test will be adjusted to allow firms to exclude one fund accounting year from the calculation.

Regulatory Aspects: On 19 May 2020 the UK Government announced that companies accessing the Large Business Interruption Loan Scheme for £50m or more will be required to suspend dividends. Some companies are now paying back subsidies which should help the dividend recovery.

Our view

BMO MM Team Comment on the Surveys and Regulations:

We expect the global dividend outlook for your diversified fund to be better than the UK-focussed surveys, but some of the same impact of the third wave of COVID-19 will cloud the short term for some overseas markets. We also note the more recent UK and global survey reports are more positive. The regulatory environment for resuming dividends continues to improve.

Continued

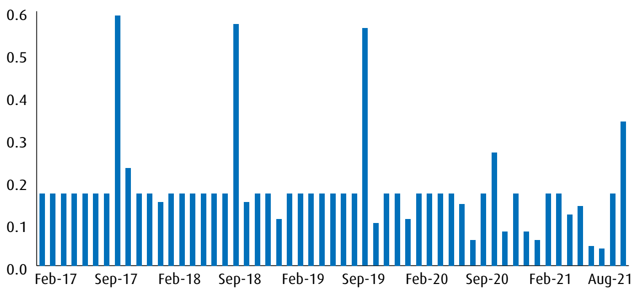
Fund's up-to-date income history

August 2021 update on the BMO MM Navigator Distribution Fund's Monthly and Quarterly Income units:

The chart below shows the monthly pence per unit payments, up to and including the amount for the end of August ex-dividend date, which will be paid at the end of September. The amount expected to be paid is the smoothed amount of 0.17ppu plus the end of the fund's financial year 'sweep' amount of 0.13 pence per unit. This makes for a total of 0.30ppu subject to any changes between the xd and payment dates.

As the fund has reached the end of its financial year we will be reviewing our current policy which is to keep paying the smoothed monthly income amount from our fund whenever possible, or if necessary, a smaller sum (representing all income received) will be paid out.

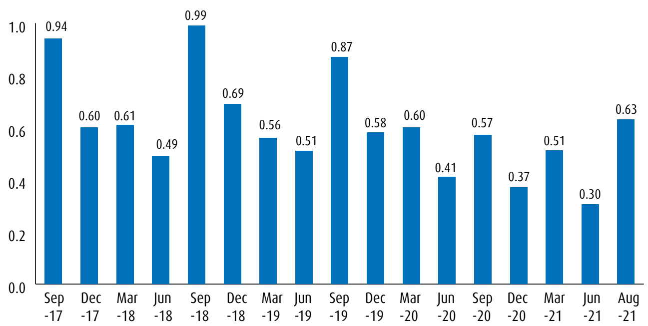
BMO Multi-Manager Navigator Distribution M Income XD rates



Source: BMO Global Asset Management as at 31-Aug-21

The chart below shows the quarterly pence per unit payments for the last three years for the C Inc share class, up to and including the ex-dividend amount for the end of August of 0.6331 pence, due to be paid at the end of November. We intend to continue to pay out as much income as we have at each quarter.

BMO Multi-Manager Navigator Distribution C Inc XD rates



Source: BMO Global Asset Management as at 31-Jul-21

Outlook

As the Distribution fund has just seen the end of its financial year, we can reflect on the income received, and look forwards to a recovery in 2021-22. Please note that all figures are based on the unaudited payment rates that are correct at the time of writing.

For the C Inc share class, income for 2020-21 totalled 1.8195 pence; this was down 15.8% on the previous financial year. The M Inc share class saw income down 15.53% over 2019-20. To give some context, we saw a stronger second half of the financial year in terms of income versus expectations, which suggests that the trend in income received is improving. Halfway through the 2020-21 financial year we estimated that income would be down 22% for the full year, so an outcome with income down 15% was a positive one against what we expected back in February.

Given the trends in underlying payments, and what we have seen in the various dividend outlook surveys, we would expect that 2020-21 should be a trough in the fund's income payments.

We hope to see a recovery in 2021-22 that would take the fund's income back to levels that are closer to what we saw in the previous financial year (2019-20) and in a best case scenario, above those levels. Certainly, the recovery in global equity income has been solid though the UK has lagged somewhat and the returns on offer in bonds remain somewhat lacklustre. But we take a lot of comfort from the trends we are seeing in the equities space, and also in alternatives and property, where the resumption of dividends from Darwin Leisure adds to the positive stories we have seen from LXI REIT, Target Healthcare and Supermarket Income REIT, all of which are paying higher dividend rates now than we saw before the pandemic.

The global dividend surveys suggest that by the end of 2021 we will still not be at pre-pandemic levels, but we will be getting reasonably close – within a few percent of the total payouts we saw in 2019. We therefore hope to see a continued recovery in our own income, notwithstanding the potential downside risks from factors such as an escalation in the pandemic or other macro factors impacting on companies' willingness to pay out higher rates of income.

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Income received since the last report

End July/ Start August

SEDOL	Fund Name	XD date	Pay Date	Latest Rate (p)	YoY Prev Rate (p)	% change
THRL LN	Target Healthcare REIT plc	12-Aug	27-Aug	1.68	1.67	0.6%
RHM LN	Round Hill Music Royalty Fund	26-Aug	06-Sep	0.1125		
BYSYZN9	Fidelity Global Enhanced Income A W IM	01-Sep	18-Oct	0.47	0.47	0.0%
BZ01WT0	Legg Mason Clearbridge Global Infrastructure Inc	01-Sep	31-Oct	1.498603369	2.282274	-34%
B8BG8H5	TwentyFour Dynamic Bond M IC	01-Sep	30-Sep	37.2881	35.8301	4.1%
SQN LN	KKV Secured Loan Fund					
SCHRINA LN	Schroder Income Fund	26-Aug	25-Oct	90.8225	42	116.2%

Source: BMO Global Asset Management as at 31-Aug-21

Stats in numbers

3 have increased, on average by 40.3%

1 has decreased by 34%

1 is unchanged

This month's news from the Fund's underlying holdings and beyond

- LXi REIT has announced three acquisitions for a total cost of £80m, reflecting a 5.25% average net initial yield (compared to a current portfolio value of 4.7%). The properties have an average unexpired lease term of 23 years with inflation-linked rental increases. The acquisitions follow LXI's £100m placing in July 2021.
- Darwin Leisure Property confirmed it was renewing income payments with the first payment due in September.

Portfolio actions taken and comments around them:

- In the portfolio during August the changes to the bond holdings continued as we continued to rotate into funds that we think can continue to deliver a reasonable income in what remains a low yield environment. We sold out of Federated Hermes Global High Yield Credit fund, a portfolio that has been a relatively short term holding but served us well in terms of performance from the pandemic lows in 2020 when High Yield, and many other assets, looked very mispriced.
- We also sold on a much longer term holding in Schroder Strategic Credit given more attractive opportunities elsewhere. The proceeds went into a new holding in the Barings Emerging Markets Debt short duration fund which we believe offers better capital and income opportunities in what remains a tough environment to find income in the bond asset class.

Continued

Some Background Income Information:

Q Why have dividend payments come under pressure?

The unknown ultimate scope of the economic impact of the coronavirus pandemic and associated lockdowns etc. initially caused many companies to prioritise retaining cash over distributing equity dividends. This has started to ease.

Q Do companies have to cut dividends?

In most cases it is voluntary, and many companies will want to preserve their dividend history through any relatively short- lived problem.

However, governments and central banks have forced certain industries to cease pay-outs and share buybacks. This has happened with the banking sector in the UK and Europe.

This action did make it easier for boards in other sectors to cut or suspend dividends. In November the ECB said banks can resume dividend payments in Q1 2021 if their balance sheets show resilience. In the UK, the Bank of England relaxed restrictions on bank dividends on 13th July with immediate effect.

There was also been pressure on companies that receive any state support in this crisis to suspend dividends. A number of major companies have repaid state aid, which is starting to free up dividend policy.

Q Is the impact different in each asset class?

Equity dividends can be suspended, maintained, cut, deferred and even cancelled after they have been announced. They can of course also still potentially be increased.

Most bonds are contractual, so their interest payments cannot be cut unless agreed with the bond holders.

Funds enhancing income through covered call option writing may see some positive impact from the heightened volatility.

Summary and conclusions

These remain potentially challenging times for all investors, and it is very unfortunate that income-seeking investors have been amongst the most affected by the COVID-19 recession. The BMO MM Navigator Distribution Fund has seen price volatility in 2020 in particular, but the fund has recovered strongly in absolute terms since the March lows, and is making progress up the peer group too since then. Further recovery will be needed to fully recover the underperformance during the sharp falls during March of last year but with another month of out-performance, it would appear that the polarised markets of the last few years are showing signs of becoming more even-handed. Importantly the fund has been able to remain in the top decile for yield within the sector as it always have been since launch in 2007. In addition to that there is significant value in the portfolio at these levels which should see the capital base improve over time in our opinion.

BMO Global Asset Management