



This month we speak to Martin Cholwill, Manager of the £218m Royal London UK Equity Income Fund. Find out where he is finding opportunities in the current economic climate and what his market outlook is.

What's driving stock selection at the moment?

Corporate updates have generally remained relatively benign, while economic newsflow points to a typical mid-cycle slowdown rather than anything more serious. This is consistent with IMF forecasts for anaemic global expansion. So, my key focus is on quality companies with strong balance sheets.

Where is performance coming from?

I've recently benefited from positive contributions from a range of holdings, as well as from my lack of exposure to mining and banks. These include Northumbrian Water, Dunelm, IG Group, Holidaybreak and Pennon. Northumbrian Water and Holidaybreak received agreed cash takeover bids and I sold both at a small discount to the bid price.

Where are you finding new opportunities?

In line with my preference for those companies with strong market positions and robust balance sheets that I expect to be the longer term winners, I've recently added new positions in United Utilities and WH Smith. United Utilities trades at close to its regulated asset value, in contrast to recent bid activity in the sector at a premium of more than 25% to asset value. WH Smith offers a dividend yield of almost 5% (and growing), a solid balance sheet and predictable cashflow, with an airport travel business that is expanding internationally.

Do you have any preference in terms of market cap?

Investors are currently overlooking the overall strength of corporate balance sheets and ongoing cashflow. This should encourage M&A activity in due course and will be supportive of the market. This underpins my preference for mid cap shares over mega cap companies. The latter are typically bid-proof and far more likely to be the ones doing the acquiring.

How will the economic outlook affect income investors?

At RLAM, our core expectation is that the economy will 'muddle through', and that growth in developed economies will remain anaemic for a number of years. Although politics remains a key risk, any resolution of the sovereign debt crisis should be a positive catalyst for the stockmarket. With interest rates low and inflation in the UK still rising, I believe that equity income funds offer an attractive source of growing income in a difficult environment.

Source: rlam as at 10 October 2011 unless otherwise stated.

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