MANAGER UPDATE

Income opportunities

March 2014

Five years of rates at record lows: what next for income?

With 5 March 2014 marking five years since the Bank of England cut the UK base rate to an emergency record low of 0.5%, three leading income managers give their views on their respective asset classes and key considerations driving fund positioning.

Fixed income

Jenna Barnard, co-manager of the Henderson Strategic Bond Fund

Bond markets are still providing plenty of opportunities for income seekers. With company default rates at very low levels, the troika of low inflation, low growth and low defaults means markets should fare reasonably well in the current environment. Inflation seems to be under control, with disinflation actually being the key theme of recent months, taking the US Federal Reserve's favoured inflation target rate down to its lowest level in 50 years and European inflation below 1%. The bulk of the debt issuance by companies so far has been for refinancing purposes and, given the limited aggressive behaviour, default rates are expected to remain around these low levels. The distribution yield on the Henderson Strategic Bond Fund is currently around 6%*.

Key considerations:

1. Within corporate bond (credit) markets, certain bank bonds are being phased out by new regulations, which will likely be replaced with new instruments. These will be loss absorbing, which means that bond investors could suffer steep losses on these bonds much more easily than in the past. We are naturally much more cautious on these instruments but one we do particularly like is a security issued by Nationwide last November yielding 10.25%; today this yields 8.5%, which is still attractive given the strength of the company (yields move in the opposite direction to prices).

2. Select stock picking opportunities can be found within the sub-investment grade (high yield) credit market. The high yield index currently yields around 4%, which is not that interesting in its own right. However, there are still good stock picking opportunities; for example the Automobile Association priced a bond to yield 9.5% last year; today it yields approximately 5% to its January 2016 first maturity date (i.e., its price has risen).

3. Government bond yield curves are close to their all-time historic steepness**, so the longer-dated the bond, the higher the yield. For example, many 30-year investment grade bonds can be found yielding in excess of 5% as a result.

Henderson Strategic Bond Fund

Discrete year performance	A Inc % change	I Acc % change	I Inc % change
31/12/2012 to 31/12/2013	3.9	4.6	4.6
30/12/2011 to 31/12/2012	17.7	18.5	18.5
31/12/2010 to 30/12/2011	-2.2	-1.5	-1.4
31/12/2009 to 31/12/2010	4.6	5.4	5.4
31/12/2008 to 31/12/2009	31.9	32.6	32.6

Source: at 31 Dec 13. © 2014 Morningstar. All Rights Reserved, nav-nav, UK sterling, net income reinvested.

Please note that the value of an investment and the income from it can fall as well as rise and you may not get back the amount originally invested. Past performance is not a guide to future performance.

Henderson
GLOBAL INVESTORS

*Source: Henderson Global Investors, 'A' income share class, distribution yield of 5.9% at 31 January 2014. This reflects the amount of income that may be expected to be distributed over the next 12 months as a percentage of the mid-market share price of the fund and is net of those charges that are taken from income and gross of any withholding tax. Annual management charges are taken from capital. **A yield curve is a plot of interest rates/yields of bonds with equal credit quality but different maturities at a given point in time. A steepening yield curve is a movement in yields, indicating long-term bond prices will fall (yields will rise) relative to short-term bond prices.

UK equity income
James Henderson, manager of the Henderson UK Equity Income & Growth Fund

A low interest rate environment would normally have encouraged businesses to borrow. The global financial crisis, however, provided such a shock to the financial system that over the last five years corporates have focused on becoming stronger by paying down debt on their balance sheets and generating cash.

As a result, the UK corporate sector is in a better position to deal with rising rates. Usually, rate rises occur at the end of an economic cycle when corporations have raised levels of debt. A disciplined cost approach of paying down debt and strengthening balance sheets has led to profit margin expansion.

Capital expenditure remains controlled, in spite of borrowing being cheap. Well-run UK companies are making good returns and have the capacity to grow and add significant value for shareholders.

Business confidence is returning and companies are now making earnings-accretive acquisitions using a mixture of both equity and debt. Examples of merger and acquisition activity in our portfolio include engineering group GKN's acquisition of Volvo Aero, the aero engine division of AB Volvo, and DS Smith's purchase of SCA's packaging division.

Looking ahead, certain companies are set to benefit from a rising interest rate environment, such as those with cash on their balance sheets, and, to give a specific example, general insurance companies such as Hiscox that earn income on premiums paid. At 31 January 2014, the Henderson UK Equity Income & Growth Fund yielded 3.2%*.

With management focused on generating cash, this should provide further opportunities for dividend growth, special dividends, shareholder buybacks and selective earnings enhancing acquisitions. This, in our view, makes it a good time to be investing in UK companies.

*Source: Henderson Global Investors 'A' income share class historical yield at 31 January 2014. The historical yield is net of charges and net of tax and is not guaranteed. Annual management charges are taken from capital.

Henderson UK Equity Income & Growth Fund

Discrete year performance	A Inc % change	I Acc % change	I Inc % change
31/12/2012 to 31/12/2013	35.2	36.5	36.4
30/12/2011 to 31/12/2012	24.3	25.5	25.5
31/12/2010 to 30/12/2011	-4.8	-3.9	-3.9
31/12/2009 to 31/12/2010	29.7	30.9	30.9
31/12/2008 to 31/12/2009	33.9	34.9	34.8

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Income opportunities (continued)

UK commercial property
Andrew Friend, acting co-manager, and Marcus Langlands Pearse, co-manager of the Henderson UK Property Unit Trust

The gradual rise of interest rates predicted by financial markets should not be a threat to the commercial real estate asset class in the short to medium term. The low borrowing rate environment witnessed since the global financial crisis has improved the attractiveness of income producing assets, such as bricks and mortar-based property funds. While there has been a rebound in commercial real estate investment activity since 2010, wider market valuations remain attractive. In fact valuations are well short of the pricing peak of 2007, providing a sufficient yield cushion should interest rates rise further. Any negative valuation fears attached to a rise in interest rates should be offset by stronger UK economic growth, a recovery in the occupier market, and a subsequent rise in rental growth on commercial property. In London and the South East, for example, there is already evidence that strong occupier demand is supporting notable rental growth. This would be a welcome return to the more traditional drivers of commercial real estate performance: income and capital. However, performance is unlikely to be uniform, highlighting the need for market and tenant knowledge and selective acquisitions in key locations.

The Henderson UK Property Unit Trust is currently yielding 3.9%; the weighted average lease length on the fund is 10.9 years and, as a result of strong active management, the fund's occupancy rate stands at around 100%*.

*Source: Henderson Global Investors 'A' income share class historical yield at 31 January 2014. The historical yield is net of charges and net of tax and is not guaranteed. Annual management charges are taken from capital; therefore capital growth will be restricted. Note, the weighted average lease length describes the average time to the expiry of leases across the portfolio, weighted by contracted income. **Performance of the I Inc share class is backdated to the inception of the A Acc share class.

Henderson UK Property Unit Trust

Discrete year performance	Acc % change	I Inc** % change
31/12/2012 to 31/12/2013	6.3	7.0
30/12/2011 to 31/12/2012	6.0	6.3
31/12/2010 to 30/12/2011	-0.1	-0.1
31/12/2009 to 31/12/2010	8.7	8.7
31/12/2008 to 31/12/2009	7.1	7.1

Source: at 31 Dec 13. © 2014 Morningstar. All Rights Reserved, bid-bid, UK sterling, net income reinvested.

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Henderson GLOBAL INVESTORS

Income opportunities (continued)

Due to the specialist nature of property investment, in certain circumstances there may be constraints on the redemption or switching of units/shares in the fund(s). The funds invest in a specialist sector that may be less liquid and produce more volatile performance than an investment in other investment sectors. The value of capital and income will fluctuate as property values and rental income rise and fall. The valuation of property is generally a matter of valuer's opinion rather than fact. The amount raised when a property is sold may be less than the valuation.

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Any investment application will be made solely on the basis of the information contained in the Prospectus (including all relevant covering documents), which will contain investment restrictions. This document is intended as a summary only and potential investors must read the prospectus, and where relevant, the key investor information document before investing.