SENECA INVESTMENT MANAGERS

Why investors can benefit from income accumulation

Seneca Investment Managers launched an accumulation share class for the VT Diversified Income Fund in Autumn last year. The move has helped cater for the demand for flexibility from both growth and income investors.

The investment case for accumulation

In later life, retirement saving provisions serve a variety of needs. For some, it is simply to partly encash and leave the remainder of their fund to grow. For others, it is to receive a sustainable return that can meet their spending needs for the remainder of their lives.

The last decade has seen strong growth in many markets. An investor withdrawing part of the capital amount as income has seen little issues as investments in the main have grown year on year. But all good things must come to an end and we believe that the natural income argument has become stronger.

Accumulation shares inside a value fund have the potential to serve both the needs of growth and income, with the ability to either reinvest the returns for growth or take the natural income for income-based needs.

For this reason, we decided to launch an accumulation share class for our investors to meet their demand for greater flexibility.

The points below outline the factors that influenced our decision to launch:

What about Growth investors?

For long-term investors with relatively ambitious growth objectives, advisers again may want to consider income funds with accumulation shares as over time the effect of "compounding" the income could boost investment pots.

What about the next 10 years?

An increasing number of market commentators and investment experts believe we are approaching the end of the bull-market run. If correct, where does this leave growth investors as markets deliver lower, sideways or perhaps even negative returns? Understanding that growth stocks may take the biggest hit to value when the market falls, could higher-yielding assets - act as a cushion in more in difficult times.

The sustainability of income reinvested for growth?

Let's use a simple example to paint this picture. Stock A has a well covered 5% dividend yield while stock B has only a 1% dividend yield. Both stocks generate zero increase in share-price over 12 months but what does the investor receive? In this example the investor would be 4% better off for having selected the higher yielding stock for its pay-out ratio and value characteristics rather than the lower yielding stock (appreciating that individual clients tax positions must also obviously be considered).

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Could the policy of income reinvestment, symptomatic of accumulation shares in income funds, give the potential for greater return in the investment markets of the next decade? Well it's difficult to predict, but with more value companies appearing in the market this may certainly be a future consideration for growth investors too.

Considerations for Advisers: accumulating income investments for growth clients?

As capital market expectations change, advised clients may be better off being on the right side of the market trade-off; this may mean having your clients' portfolios exposed to income yielding value shares, offering the benefits of a natural yield– rather than to lower yielding stocks relying on capital growth that has been the key feature of the last decade.

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