Miller/Howard High Income Equity Fund And The New Year

Dividends, returns and a ten year term limit make HIE worth taking a look at.

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By **Thomas Hughes**
Senior Editor of Global Investor Spotlight

Yield And Performance During Tough Times

Conditions in the financial markets are tough to say the least. Poor corporate earnings, plunging energy prices and geopolitical risks have driven the US indices down to 3 month lows. This is no doubt having an affect on individual stocks, ETF's and managed funds alike. The difference is that managed funds often produce market beating income that can take the sting out of market downturns and produce greater total returns over time.

Actively managed funds like the Miller/Howard High End Equity Fund focus on the specific conditions, irrespective of industry, that produce desired results, not the vanilla approach that index or sector based ETF's provide. In this case the focus is income, income growth and capital appreciation. The fund strategy looks for companies that are undervalued with solid balance sheets then targets those with the highest dividends, and the greatest chance for an increase in dividend distribution. This allows for a high level of current income and capital appreciation, the operative factor being stocks in a cycle of dividend increases tend to attract new buyers and premium pricing. At this time the fund is trading near $10 per share and yields close to 14%.

One of the features that makes this fund so unique when comparing to other closed end funds, mutual funds or ETF's is that it has a term limit of 10 year. This means that the fund will sell out of its holdings and NAV will be returned to share holders, alleviating concerns of value trap. Most closed end funds including this one, tend to trade at a discount to NAV which means that without a term limit it may not be possible to realize the full value of the investment.

NAV, Discount To NAV And Total Returns

NAV has been declining since the funds inception but can be directly attributed to market conditions in 2015. For one, dividend paying stocks fell out of favor, a situation fund managers are aware of and addressed in the annual letter to shareholders; the HIE is heavily biased toward high paying issues, the very basis of its high yield cash flow strategy. Another reason for declining NAV is plunging oil prices which have taken a toll on the entire energy sector, a sector well known to provide above average dividend distributions as well as dividend growth. Yet another reason for stock market declines, and subsequent declines in HIE's NAV, can be blamed on the FOMC and the fear of rising interest rates. The good news is that fund managers are expecting yield and dividends to regain market leadership in 2016 as prices fall and yields increase.

"Dividend payers have been conspicuous laggards for three years – a highly unusual condition in the history of the markets where higher-dividend-paying stocks are categorically a persistent source of excess returns over long periods. We expect that lagging valuations and aging demographics are big factors in our favor since these will increase investor demand for income stocks and drive returns for our shareholders." **Miller/Howard 2015 letter to shareholders**

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Market conditions and declining NAV have contributed to a decline in share prices as well. In fact, share prices have outpaced the decline in NAV resulting in a discount nearly double the one year average. The current discount is near -14%; the 6 month average is closer to -9%, the one year Z statistic near -1.59%, both suggesting that the fund is undervalued. Additionally, the discount has been narrowing from its peak set a few months ago suggesting that there are already some who recognize the value and returns inherent in this investment.

There's no way to sugar coat it, total returns over the past 13 months, the life to-date for this fund, are not good. HIE has returned a loss of -43% in terms of prices and over -30% in terms of NAV, both exceeding the industry average and the Morningstar benchmark. In that same time dividends have been paid steadily, amounting to $1.39 per share, nice but not enough to reverse loss of equity. Original shareholders with cost basis near $20 are still realizing negative returns, at least on paper. The thing to keep in mind is that this fund has a term limit and is intended to be held until expiration. Taking that into consideration, and factoring in 10 years of steady dividend payments, total returns for original owners are more like 26%. New owners, at today's prices, are looking at a potential return of 150%, assuming of course NAV remains stable. If you think the secular bull will drive the market higher over the next 9 years, as I do, potential returns grow.

S&P 500 earnings are expected to grow at a rate of 7% in 2016 with growth expanding into the end of the year, US GDP is expected to expand to a rate of 3% or greater in 2016, both expected to continue expanding in 2017, three reasons to believe the long term bull market is still alive.

The Fund Is Young But The Dividend Is Healthy

The fund is young, just over a year old, but there are over 100 years of collective experience backing the strategy. Miller/Howard has been in business nearly 20 years specializing in dividend, income, dividend growth and energy focused investment strategies, Mr. Miller himself having more than 20 years in the industry. Their strategy, and the funds very make-up, channel all of that knowledge into one uber strategy.

The fund has to date been able to cover all of its distributions through earnings and is only expecting to improve this into the future. Dividends and special dividends received from portfolio holdings cover most of the distributions paid to shareholders to date. This is enhanced through leverage and option strategies but both in a manner that keeps risk low. Leverage is low, only about 16%, very low compared to other high income funds, and is expected to be phased out over time. The remainder of income is earned through options strategies. The funds prospectus allows for up to 20% of the portfolio to be leveraged through options but so far this has not exceeded 8%. To date 31 puts ad 7 calls have been sold; 28 of the puts expired worthless, 3 resulted in the purchase of stock managers wished to buy.

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Certainly Worth A Second Look

This fund is certainly worth a second look. Other than risk of continued loss of NAV and/or cuts to the dividend I really can’t see a reason not to own this fund. It provides exposure to dividends, it targets divided growth, it seeks capital appreciation, it pays a healthy income, it trades a significant discount to NAV, total returns if held to term are attractive, it has an exit strategy and over all, market outlook is good.