EDISON

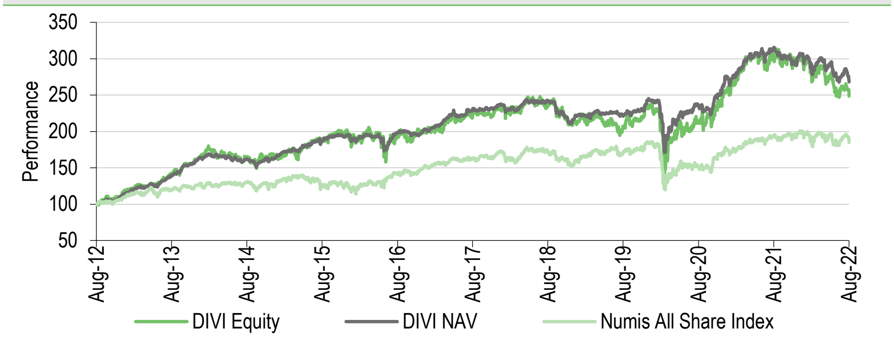
The Diverse Income Trust

An opportunity for the short and long term

Investment trusts
UK multi-cap equity income

Multi-cap Diverse Income Trust (DIVI) continues to be among the top-ranked UK high-dividend-yield trusts, despite some setbacks in short-term performance against peers due to its relatively high small-cap and AIM exposures (see page 3 for details). These segments of the UK market underperformed over the past 12 months. Portfolio managers Gervais Williams and Martin Turner are confident about both DIVI's short- (should the global and UK equity markets continue to rally in H222) and long-term performance catch-up relative to peers and indices. They expect the multi-cap income approach will continue to deliver returns ahead of the market, and for the UK equity market to outperform the United States.

DIVI's performance* over 10 years



Source: Refinitiv, Edison Investment Research. Note: *Performance rebased; total return in pounds sterling terms.

Why invest in DIVI now?

The multi-cap nature of DIVI's portfolio differentiates it from the mainstream UK equity indices, hence making it a potentially performance-enhancing addition to a UK equity investor's portfolio. Alpha generation and the low correlation of DIVI with major UK indices has resulted in a steady long-term total return (TR). The trust has continued to deliver an attractive dividend income throughout its 11-year life, including the COVID-19 pandemic period. In FY22 (to end-May 2022), the ordinary dividend was up from 3.75p to 3.90p, an increase of 4%, fully covered by portfolio revenue, following a 1.4% increase in FY21. The managers only buy shares that generate a substantial cash payback and are excited about opportunities in H222 and beyond.

The analyst's view

We believe DIVI is well positioned to outperform indices and peers over the long term, given its income-generating multi-cap strategy and diverse sources of income. DIVI's strategy and the portfolio's diversification (c 130 holdings) mean the trust's portfolio has not changed significantly throughout its life. In 2021 and H122, as the AIM market underperformed the broader UK market, DIVI's performance lagged larger cap dominated peers with a -13.7% 12-month NAV TR versus -3.9% for peers (see page 5). Given the increased risks of a recession, the recently purchased UK large-cap equity index put option covering the period to December 2023 (replacing the one expiring in December 2022) should enable DIVI to withstand (and even benefit from) any potential market correction.

NOT INTENDED FOR PERSONS IN THE EEA

13 September 2022

Price	**94.0p**
Market cap	**£334.5m**
AUM	**£357.7m**
NAV*	99.0p
Discount to NAV	5.0%
NAV**	100.5p
Discount to NAV	6.5%

*Excluding income. **Including income. At 9 September 2022.

Yield	4.2%
Ordinary shares in issue	355.9m
Code/ISIN	DIVI/GB00B65TLW28
Primary exchange	LSE
AIC sector	UK Equity Income

52-week high/low*	121.5p	91.8p
NAV** high/low	118.9p	98.6p

*A-shares. **Including income.

Gearing

Gearing at 31 July 2022	0.0%

Fund objective

The Diverse Income Trust's objective is to provide an attractive and growing level of dividends, coupled with capital growth over the longer term. It invests in a diversified portfolio primarily of quoted or traded UK companies across the market-cap spectrum, with a bias to high-quality small- and mid-cap stocks. Because it builds a stock-specific portfolio, the team does not use a benchmark.

Bull points

- Multi-cap strategy helps to diversify away from dividend concentration risk.
- Consistent growth in regular dividends since the trust's launch in April 2011.
- Revenue reserves can be used to help maintain the pattern of dividend growth.

Bear points

- The UK market could remain out of favour and retain its valuation gap with developed markets.
- A multi-cap strategy is not a clear-cut asset class to fit into an investor's portfolio.
- DIVI's labour-intensive, active multi-cap mandate results in a relatively high management fee.

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Edison profile page

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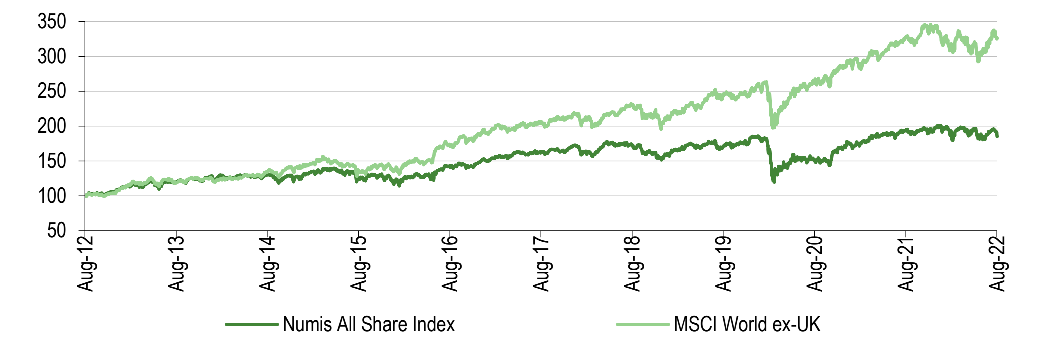
Managers' view: Expect the UK market to catch-up

DIVI's managers expect a combination of a large number of strong listed businesses and institutional investment flows to these to boost the UK market's performance over the medium to long term (three to 10 years). As they see more regions sourcing supplies closer to home, large quoted companies will have limited scope for growth. In such an environment, growth and superior returns will come from small and agile businesses, says Williams. Those small and agile companies that have sustained the tough test of the pandemic and lockdowns are well placed to offer investors better long-term return potential than large caps. The managers anticipate this outperformance to arrive regardless of challenges for the UK economy, as Great Britain, alongside Europe, the United States and other developed countries, manages inflation issues and low economic growth.

Small caps did outperform prior to the globalisation boom of the nineties, and the managers anticipate this outperformance to return. They expect small-cap and particularly AIM-listed stocks to propel a UK equity market recovery within the next few years and result in outperformance of the US and other developed markets. The managers note in DIVI's annual report to the year ending May 2022 (FY22) that UK-quoted small- and micro-caps have historically delivered premium returns, so a sizeable number of institutions made capital allocations to them. During the period of globalisation, as asset returns, including those for global, and particularly US, large caps were plentiful, institutional allocations into quoted small and micro-cap stocks have been crowded out by larger weightings in long-duration assets, such as the US technology unicorns. Exhibit 1 illustrates the UK market's underperformance to global equities over the past 10 years to end-August 2022, with Numis UK All Share Index TR of 89% versus 225% for the MSCI World ex-UK Index.

Exhibit 1: 10-year performance

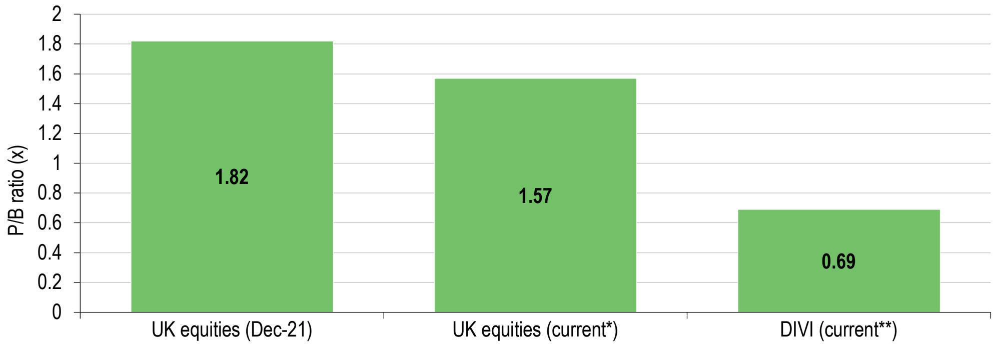


Source: Refinitiv, Edison Investment Research. Note: *Performance rebased, TR in pound-sterling terms.

The UK equity market in 2022 has thus far, in contrast with recent years, held up better than most other markets globally. The Numis All Share Index TR of -3.1% compares with a -5.0% TR for the MSCI World Index to end-August 2022. The managers attribute this partly to the UK's sector mix with a sizeable proportion of energy and materials companies, having exposure to higher commodity prices (eg Shell, BP) and banks, whose margins benefit from higher interest rates. Another notable outperformance factor is the UK market's low valuation relative to the US and global equities. They believe that the notable outperformance of UK equities is yet to come. As more investors notice a strong performance from UK equities, they will invest more and further boost the UK market.

What excites the managers even further is that the UK market will grow from the lower base. Exhibit 2 illustrates that the price-to-book (P/B) ratio for UK equities, based on a UK all-cap index, has dropped from 1.82x at end-December 2021 to below 1.57x at end-August 2022, and continues to fall. Given DIVI's P/B of 0.69x (at end-July 2022, source: the company), the growth prospects of DIVI's portfolio companies are even higher, according to Williams.

Exhibit 2: P/B ratio for DIVI versus UK equities, based on a UK all-cap index



Source: Bloomberg, The Diverse Income Trust . Note: *As at end-August 2022. **As at end-July 2022.

Portfolio positioning

The proportion of AIM and small-cap stocks in DIVI's portfolio, at 38.7% and 17.2%, respectively (at end-July 2022), remained little changed compared to end-December 2021 (37.2% and 17.1%, respectively, Exhibit 3). Together they represent the largest share of DIVI's portfolio at 55.9%.

Exhibit 3: DIVI's capitalisation weighting

	End July 2022 (%)	End December 2021 (%)	Change (pp):
AIM stocks	38.7	37.2	1.5
Large caps	21.2	22.6	-1.4
Small caps	17.2	17.1	0.1
Mid caps	16.1	14.8	1.3
UK listed non-index shares	1.5	2.0	-0.5
Other (fledging, bonds)	1.1	2.1	-1.0
Overseas	0.0	1.3	-1.3
Cash	3.1	1.8	1.3
UK large-cap index put option	1.1	1.1	0.0
Total:	100.0	100.0	

Source: The Diverse Income Trust

DIVI continues to source its income from a wide range of sectors (Exhibits 4 and 5).

Exhibit 4: Portfolio breakdown by sector*

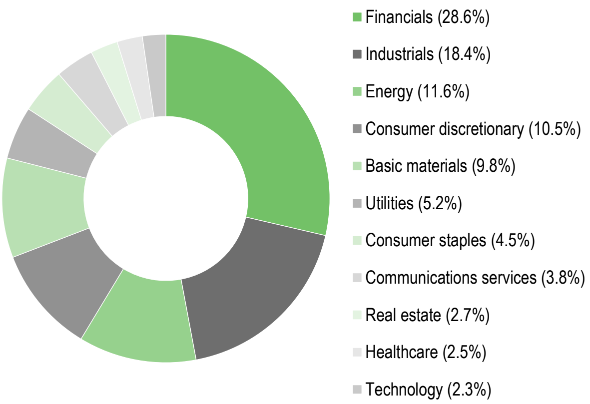
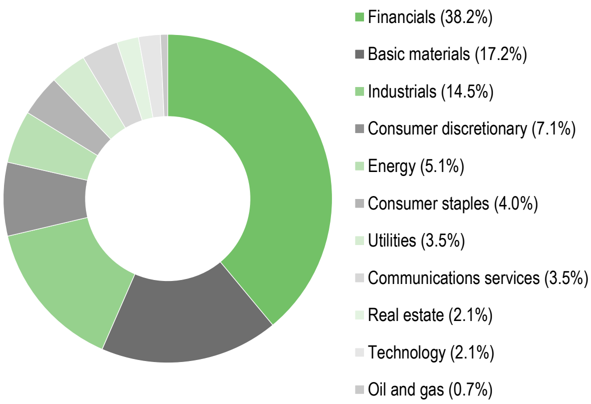


Exhibit 5: Actual income by sector



Source: The Diverse Income Trust, Edison Investment Research. Note: Data at end-May 2022. *Rebased for cash.

The top five sectors by exposure account for the bulk of the portfolio (78.1%) and income (82.1%). Although the trust has a high proportion of cyclicals, such as financials, materials and energy, in the portfolio, its sector representation differs from that of a major UK large-cap index, and hence offers a differentiated source of income to investors, from selective cash-rich companies in each sector.

Financials is the biggest sector (28.6%, see Exhibit 3) and brings the largest proportion of portfolio income (38.2%, Exhibit 4). This sector contains a wide range of financial businesses, big and small. The top 20 holdings include a large insurer, Legal & General (1.5% of the portfolio at end-July 2022), and Man Group (1.9%), an investment management company. The top 20 list also contains K3Capital (2.0%), an AIM-listed corporate finance business for SMEs that targets growing dividends for the next two years; CMC Markets (2.2%), a financial derivatives dealer; and XPS Pensions Group (1.6%), an employee benefit consultancy firm. XPS Pensions Group serves customers in the UK, offering pensions actuarial, administration, compliance and advisory services and has exciting growth prospects, according to the investment managers.

The industrial sector is the second largest (18.4%) and is very diverse. Williams highlights that most industrial companies within DIVI's portfolio are not very cyclical. Among the industrial holdings are Mears Group (top 20 holding, 1.3%), a social housing repairs and maintenance service provider for local authorities and registered social landlords in the UK. Mears employs over 15,000 people and provides services to over 10% of the UK social housing stock. The managers believe this construction and services business has considerable growth potential in the UK. Other holdings include Smurfit Kappa, a manufacturer of paper packaging products, and Forterra, a manufacturer of masonry products, such as clay bricks and concrete blocks.

The energy sector, which has performed strongly so far in 2022, has the third largest weighting (11.6%) and contains i3Energy (top holding, 3.5%) and Savannah Energy (1.8%). With the fifth largest weighting, basic materials sector (9.8%) is second top in terms of income contribution (17.2%). This sector includes Kenmare Resources (fourth top holding, 2.2% of the portfolio at end-July 2022). Williams and Turner have considered mining companies to be good value during the past few years and have built and maintained exposure to the sector.

Non-conventional technology stocks include Concurrent Technologies, an AIM-listed semiconductor manufacturer for the communications industry. It designs, manufactures and markets single board computers used in the telecommunication, telemetry, military and aerospace industries. Other companies paying generous dividends include CML Microsystems, a semiconductor manufacturer in the communications sector, and iEnergizer, a business outsourcing services company.

Divestments in the last 12 months due to strong performance included BHP Group, Charles Stanley, River and Mercantile and WM Morrison Supermarkets. The released cash was invested across various sectors, and purchases included Adriatic Metals, BAE Systems and Provident Financial.

Performance

Exhibits 6 and 7 illustrate DIVI's outperformance of the Numis All Share Index over three, five and 10-year periods, when long-duration (or growth) assets were generally outperforming. DIVI's discrete performance is little correlated with UK indexes, as Exhibits 6 and 7 also show.

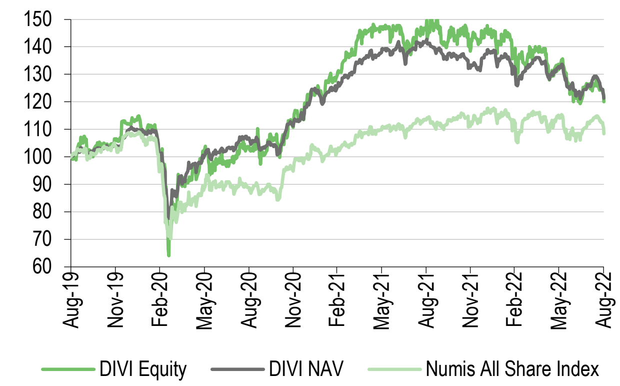
Exhibit 6: Five-year discrete performance data

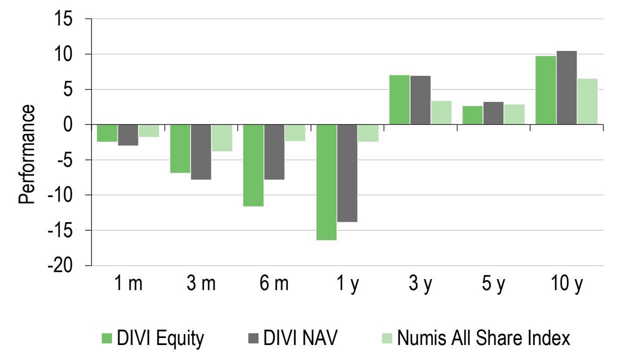
12 months ending	Total share price return (%)	Total NAV return (%)	Numis All Share Index (%)	Cboe UK Small Companies (%)	AIM All-Share Index (%)	MSCI World ex-UK Index (%)
31/08/18	6.6	4.7	4.6	3.4	10.7	10.9
31/08/19	(12.8)	(8.4)	(0.4)	(8.7)	(20.0)	6.7
31/08/20	3.8	6.9	(11.2)	(10.2)	11.8	7.1
31/08/21	41.5	33.0	27.6	66.6	35.3	25.2
31/08/22	(16.4)	(13.9)	(2.5)	(7.9)	(30.9)	(0.9)

Source: Refinitiv. Note: All % on a total return basis in pounds sterling.

Exhibit 7: Investment company performance to 31 August 2022

Performance and NAV total return, three-year rebased	Performance and NAV total return (%)





Source: Refinitiv, Edison Investment Research. Note: Three-, five- and 10-year performance figures annualised, on a total return basis in pounds sterling terms.

Divi's discrete performance over the five years to 31 August 2022 was mixed relative to the Numis All Share Index (Exhibit 6), such that the trust's NAV underperformed in two periods out of five on a TR basis and was almost on par with the index during the 12 months to end-August 2018. However, DIVI has performed more strongly over longer periods (Exhibit 7). DIVI's multi-cap approach led to the less volatile performance compared to the Cboe UK Small Companies and AIM All-Share indices (Exhibit 6).

Exhibit 8 compares DIVI's performance with 11 peers in the UK income sector. DIVI is the second top performing fund over three years and since launch in April 2011, and sixth over five years, on an NAV TR basis. The short-term one-year performance to end-August 2022 ranks DIVI at the bottom of the 12 companies in the peer group, as its AIM-listed stocks lowered the TR over the period.

Major UK all-cap, small-cap and AIM indices returned -2.5%, -7.9% and -30.9%, respectively, on a TR pounds sterling basis (see Exhibit 6) for the 12 months to end-August 2022. This explains DIVI's underperformance over one year, relative to larger-cap peers, as DIVI had over half of its portfolio in a combination of AIM-listed (39%) and small-cap stocks (17%) at end-July 2022.

Exhibit 8: Selected peer group at 31 August 2022*

% unless stated	Ticker	Market cap £m	NAV TR 1 year	NAV TR 3 year	NAV TR 5 year	NAV TR since launch***	Discount (cum-fair)	Ongoing charge	Net gearing	Dividend yield (%)**
Diverse Income Trust	**DIVI**	**334.5**	**(13.7)**	**22.7**	**17.6**	**200.3**	**(6.5)**	**1.1**	**100**	**4.2**
Aberdeen Standard Eq Inc Trust	ASEI	156.5	(2.9)	8.9	(3.4)	79.9	(11.0)	0.9	100	6.6
BMO Capital & Income	BCI	323.3	(5.5)	10.3	16.6	110.1	(3.9)	0.6	107	3.8
City of London	CTY	1,913.7	5.2	14.6	18.8	123.5	1.8	0.4	108	4.9
Dunedin Income Growth	DIG	437.4	(10.9)	12.1	22.9	96.6	0.0	0.6	108	4.4
Edinburgh Investment Trust	EDIN	1,031.1	(2.8)	14.5	2.7	121.0	(7.7)	0.5	110	4.1
Finsbury Growth & Income	FGT	1,848.3	(5.3)	(0.8)	28.3	229.1	(4.5)	0.6	100	2.1
JPMorgan Claverhouse	JCH	417.3	(6.4)	8.8	12.9	104.9	(0.8)	0.7	111	4.6
Lowland	LWI	332.3	(8.4)	10.8	(1.2)	106.0	(6.4)	0.6	114	5.0
Merchants Trust	MRCH	762.7	4.1	37.4	37.8	137.7	1.3	0.6	113	4.9
Murray Income Trust	MUT	974.5	(7.6)	13.6	26.7	112.1	(8.3)	0.5	108	4.3
Temple Bar	TMPL	725.0	0.9	2.7	2.1	87.6	(5.5)	0.5	109	3.6
Simple average (12 funds)		**771.4**	**(3.9)**	**13.3**	**13.7**	**112.4**	**(4.3)**	**0.6**	**107**	**4.4**
Rank in peer group		**9**	**12**	**2**	**6**	**2**	**6**	**1**	**10**	**8**

Source: Morningstar, Edison Investment Research. Note: TR, total return. Net gearing is total assets less cash and equivalents as a percentage of net assets. 100=ungeared. *Performance to 31 August 2022 based on cum-fair NAV. **Based on historical dividends. ***Since DIVI's launch on 28 April 2011.

With UK markets performing strongly over recent quarters, many AIM-listed companies raised additional capital during 2021, ahead of the year end. Therefore, during November and December there was an unusually large number of small-company fund-raisings, which led, as the portfolio managers put it, to 'some market indigestion', so these stocks showed weak performance at the start of 2022. When geopolitical and economic events unfolded during H122, small-cap and AIM-listed companies continued to underperform, as investors preferred to reduce risk and own large caps.

UK large-cap index put option

The managers have recently purchased a UK 100 index put option covering the period to December 2023, replacing the put option purchased in Q421, which was due to expire in December 2022. This insurance costs c 1% of NAV a year, but the managers believe market volatility will continue in 2022 and prefer to insure the fund from any sharp market correction, similar to the one in March 2020. DIVI did have a put option in place then and exercised it at a profit, generating c £20m of surplus cash into the fund.

Dividend policy, record and guidance

DIVI's primary objective is to provide shareholders with an attractive and growing level of income, as well as deliver capital growth over the long run. The board has a policy to build revenue reserves during the years of generous dividend payments from portfolio companies and uses them as necessary when dividend payments from portfolio companies subside.

Over the past 10 years, DIVI's regular dividend has grown at an annual compound rate of 7.2%, marginally exceeding the annual growth target of 5–7% per year anticipated by the team during normal market conditions.

Revenue reserves stood at £15.9m at the end of FY22 (to end May 2022). This is equal to c 1.2x the ordinary annual dividend payment. The company's revenue return for FY22 was £14.5m. This covered the dividend for the year (£13.8m) 1.1x. During FY22, the four dividends declared to shareholders have increased from 3.75p to 3.90p, an increase of 4%. DIVI's revenue per share for the year to 31 May 2022 exceeded that of the year to 31 May 2019, before numerous dividend cuts by UK quoted companies during the pandemic. The balance of the revenue earned in FY22 (£0.7m) added a small amount to revenue reserves, available to support future dividend growth, in case the portfolio's dividend income is held back by rising inflation and slower growth over the year ahead.

Board: Director change

The board currently comprises five directors (see Exhibit 9). Charles Crole was appointed as an independent non-executive director, with effect from 1 February 2022. Paul Craig, who had served as a non-executive director since 2011, stood down following the appointment.

Exhibit 9: DIVI's board of directors

Board member	Date of appointment	Remuneration in FY22	Number of ordinary shares at end-FY22
Andrew Bell (chairman)	1-Jan-19	£40,500	200,000
Charles Crole	1-Feb-22	£9,667	9,091
Caroline Kemsley-Pein	1-Jan-19	£29,000	38,289
Michelle McGrade	10-Oct-19	£29,000	63,616
Calum Thomson	20-Dec-16	£33,000	53,591
Paul Craig	2011*	£21,750	42,625

Source: DIVI. Note: *Resigned as a director on 28 February 2022.

The managers and fund profile

DIVI was launched in April 2011 as a multi-cap UK income and growth strategy by Gervais Williams and Martin Turner, who continue to co-manage the trust. Williams is a well-known manager of UK equities within the City of London. His passion for UK equity investing combined with his experience and strong performance track record make him an influential opinion leader within UK investment circles.

The fund remains the only pure multi-cap fund within its UK income closed-end peer group. Unconstrained by index considerations, the managers have a wide universe to source attractive stocks. Their investment approach is bottom-up, looking for companies that are able to generate sustainable cash flows and underpin long-term dividend growth. Williams and Turner are smaller company specialists and often find interesting investment opportunities in this segment of the UK equity market. Small caps can operate in sectors that are not represented by companies in the mainstream indices, thereby offering genuine diversification benefits. Furthermore, they can be overlooked by sell-side analysts, which can result in underappreciated valuations.

ESG: Active engagement with companies

The portfolio management team seeks to pick companies that deliver outstanding service levels. Following the qualitative analysis, only companies whose boards know the tasks and challenges of staff at all levels, from top management to shop floor, are considered potential DIVI holdings. The team collects this information, asking company management a number of relevant questions. These include how often they do staff surveys, the date of the last staff survey, the key outcomes of the survey, and whether the results of the staff survey are included in the board papers. The portfolio managers follow up on these metrics regularly, as any dip in staff engagement is often reflected in a dip in customer service and profit margin. They usually ask the management teams of the trust's holdings to report on staff engagement and service standards regularly via their presentations and annual reports.

On top of this, the portfolio team engages with companies, aiming to identify and scale back the downside risks to the business. Routinely this involves asking about the safety record, about near misses and if appropriate why this data is missing from their presentations and annual reports. In some industries such as mining, where safety is considered as the number one agenda item in all internal meetings, DIVI's team requests to highlight this at external meetings as well. Nearly all of the trust's holding companies now report safety data as the first datapoint in their communication. A recent good example is DIVI's holding Pan African Resources (Edison's corporate client), where safety was discussed in the first sentence in the news release for investors.

DIVI also continues to engage on remuneration, board composition and corporate purpose in the way it has done for many years. For most of the companies in which the trust invests, these arrangements are already in a position that the portfolio managers consider appropriate. As part of the monitoring process and ongoing engagement with holding companies, DIVI has regularly voted against the remuneration reports of numerous large-cap holdings, because the remuneration of the top executives has been considered out-of-line with the value they have added for some time.

In terms of climate change, the team engages with all the trust's holdings on how to identify the quantum of the carbon emissions, and then over time find ways to scale it down. Some companies already have very limited carbon emissions. In some instances, DIVI invests in companies with relatively high emissions, where they believe these emissions will be scaled back considerably.

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