EQUITY INCOME,
IT'S A MULTI-DECADE THEME

After nearly a decade of incredibly easy monetary policy, the global interest rate cycle is turning. The US Federal Reserve has started to increase official interest rates and unwind quantitative easing and in Australia, although official interest rates are on hold, the next move is more likely to be up rather than down. So where does this leave equity income strategies that have benefited so much from historically low interest rates?

Structural themes matter most

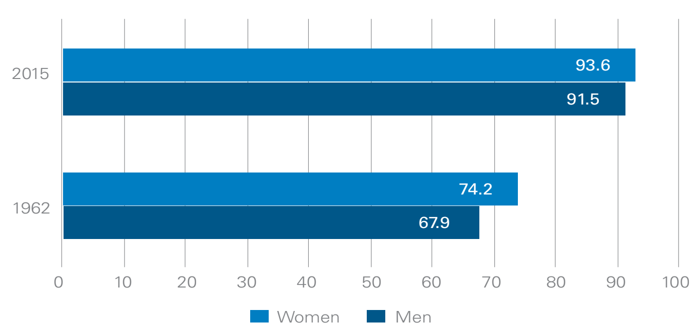
Right now, we are in the early stages of the interest rate cycle but it's not really policy ***tightening***. It's actually policy ***normalisation***. It's all about taking the US Federal Funds rate from zero back up to a more "normal" level relative to history, now that the US economy has recovered. And it's important to remember that it's ***cyclical*** – it should only continue for a relatively short period of time.

The more significant long-term driver of demand for equity income is a ***structural*** change in demographics that isn't going to disappear anytime soon. The dominant "baby boomer" generation is entering retirement and seeking to generate sufficient income on which to live. So income is becoming an increasingly important component of investment returns. Meeting the income requirements of these investors in a relatively low interest rate world is a project spanning decades and it will inevitably require continued diversification of yield portfolios with a strong focus on equities.

The demographic imperative of income growth

Australians are also living longer and this trend is forecast to continue. As the chart below shows, the life expectancy of Australian men and women is now over 90 years and has increased by around 20 years since 1960.

Australian life expectancy (at birth)



Source: Australian Institute of Health and Welfare, Australian Treasury Intergenerational Report, ABS, March 2018

So the probability that we outlive our savings is growing – this is known as longevity risk. Investors seeking income should therefore focus on solutions that can provide a sustainable, growing and real (after inflation) income stream, while also protecting their capital base. In our view, this requires a change in investor behaviour and the need to challenge some traditional investment approaches.

Legg Mason's income solutions

A successful equity income fund needs to focus on two objectives. Firstly, it should target companies whose dividends are both sustainable in difficult economic conditions and are expected to increase in value over time. Secondly, through active management of company selection, the goal is to identify companies that offer the potential for long-term capital growth, thus increasing the value of units for the investor. Legg Mason specialist equity affiliate, Martin Currie, has a suite of equity income products designed to meet these specific needs.

The *Legg Mason Martin Currie Equity Income Fund* invests in Australian companies that have high quality business models and solid track records of paying dividends through the business cycle. It aims to provide investors with the benefits of high, growing income and franking credits combined with the potential for less risk than the overall share market.

The *Legg Mason Martin Currie Real Income Fund* invests in ASX-listed securities that hold real or 'hard' physical assets including listed property, utilities and infrastructure (A-REITs, toll roads, ports, airports, electricity and gas grids). Very few investment funds in Australia offer this combination of real assets.

Both Funds are rated highly by research houses and have a strong performance track record, having delivered investors a total return (net of fees) of 8.2% pa and 13.6% pa respectively over the past five years.[1] The *Legg Mason Martin Currie Equity Income Fund* is expected to provide a dividend yield of 7.5% (grossed up for franking credits) over the next 12 months on a forward-looking basis, whilst the corresponding yield forecast for the *Legg Mason Martin Currie Real Income Fund* is 6.2%.[2]

MARTIN CURRIE

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