THE REAL RISK/RETURN TRADE-OFF
FOR INCOME INVESTORS

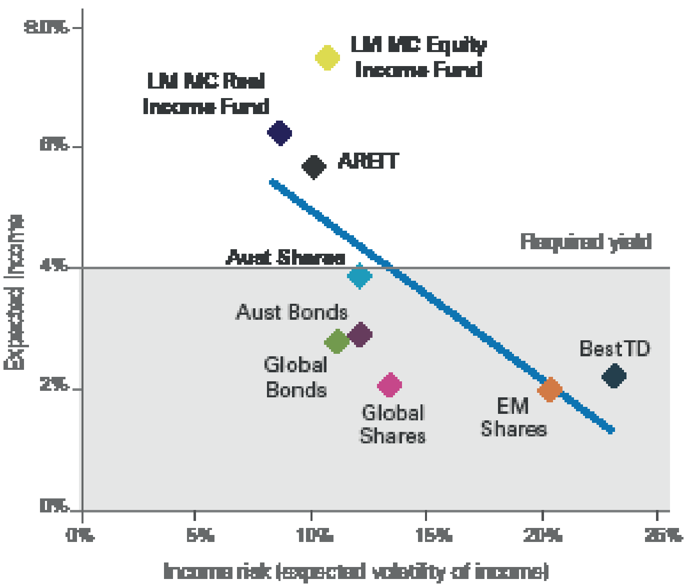
Income Solutions For Life

The traditional approach to portfolio construction looks at the potential total return of an investment (capital plus income) and compares it to the expected risk, with the aim of creating a portfolio that can deliver the best possible level of expected return for a given level of risk. But this only makes sense if your investment objective is focused on return. If you are an income investor, your objective is to generate a sustainable and growing income stream and a different approach to portfolio construction is required.

The real risk for income investors

Income investing involves a different risk. Delivering an acceptable level of income is the main challenge for the Portfolio Manager, hence low risk in this context is sustainable income. Putting this a different way - what really matters for income investors is that the fund delivers a sustainable and growing income stream, the main risk is that it does not. So, for income-oriented funds, reducing the volatility of the income stream should be the primary consideration.

Expected income and income risk



Source: Martin Currie Australia, ASFA, Factset; as of 31 March 2018. Income is calculated using manager assumptions for each asset class – because of this, the returns quoted are estimated figures and are therefore not guaranteed. Data calculated for representative Martin Currie Australia Equity Income and Real Income accounts in A$ gross of management fee; gross performance data is presented without deducting investment advisory fees, broker commissions, or other expenses that reduce the return to investors. Assumes zero percent tax rate and full franking benefits realised in tax return.

Portfolio construction for income investors

The chart shows how the major asset classes fare when the portfolio construction trade-off is redefined as expected income versus income risk (also known as the expected volatility of the income stream). Interestingly, term deposits do terribly as the dramatic drop in interest rates over the past decade means that the volatility of the income offered by term deposits is actually worse than emerging market shares! Australian shares and REITs do better but even they are surpassed by dedicated equity income funds that target the companies that matter most to income investors – those with high dividends that are both sustainable in difficult economic conditions and are expected to increase in value over time.

Legg Mason's income solutions

Legg Mason specialist equity affiliate, Martin Currie Australia, has a suite of equity income products designed to meet the specific needs of income investors.

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 a high and growing income stream which seeks the full benefit of franking credits. A diversified portfolio of high quality companies also provides the potential for less risk than the overall share market.

The *Legg Mason Martin Currie Real Income Fund* also aims to provide a high and growing income by investing in ASX-listed securities that hold real or 'hard' 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.

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%.[1]

For more information on Legg Mason's equity income solutions please visit www.leggmason.com.au or call us on 1800 679 541.

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1 The yield forecast for the next 12 months is as at 30 April 2018 and is calculated using the weighted average of broker consensus forecasts of each portfolio holding and research conducted by Legg Mason Asset Management Australia Limited and is gross of fees. Neither the yield forecasts nor past performance is a guarantee of future results.