

Income matters

Providing the foundation for an exciting new chapter in your life

Nobody knows quite what the future holds. The good news is we are all living longer. Advances in medicine and healthier lifestyles have led to an increase in the average life expectancy of both males and females.

The bad news is we have to find ways of funding that retirement and longevity. But low interest rates and bond yields – the traditional sources of income – aren't sufficient to sustain a proper living.

VARYING INCOME

Changing life plans and priorities will mean we encounter varying income needs and goals throughout our life, and, when investing, certain innate behavioural traits will influence our decision-making.

With interest rates at historic lows, investors need to consider diversifying across asset classes and internationally to obtain the desired levels of income. Equities, emerging market (EM) debt and high-yield corporate bonds could help generate a real yield, albeit at some risk to capital.

ATTRACTIVE INCOME

Weak domestic growth and unorthodox monetary policies have pushed down core bond yields and kept bank account cash rates low. Investors are likely to find it difficult to generate a 'decent' real income from many sources previously considered reliable and 'safe'. Dividends from equity holdings provide a stable and consistent source of income.

ALTERNATIVE INCOME

Emerging market debt provides a high yield. Many EM economies have lower government debt levels than G7 countries but offer higher yields, providing attractive opportunities for investors.

The investable universe of EM debt has grown significantly in recent years. Active management is key to seeking out the attractive opportunities and avoiding those that are most at risk.

Flows into EM debt also dramatically changed over the course of 2016, with macroeconomic data appearing stronger now than in the first few months of the year.

HIGH-YIELD SECTOR

Given the yields available from both the US and European high-yield sector, and the current low level of defaults, some investors may prefer high yield over investment-grade bonds.

While there are concerns over the high-yield energy sector, the US high-yield market is highly diversified by sector and includes access to many other quality names. Most companies can still comfortably afford their interest payments.

INVESTMENT IMPLICATIONS

In this current environment, investors need to think beyond traditional sources of income to beat

inflation, and if appropriate consider multi-asset investing. This may mean taking on more risk, but a well-diversified portfolio can help reduce volatility.

Equity dividends can be an important source of income and have historically been very stable, so it may be worth thinking about EM and high-yield debt as part of a portfolio as they can offer attractive yields relative to core bonds. ■

FORMULATING THE RIGHT APPROACH TO GENERATING INCOME

Investing for income can play an important role in helping you to achieve your goals at any stage of your life. Having in place an income strategy can provide the foundation for an exciting new chapter in your life. When you're thinking about helping to fund your retirement, formulating the right approach to generating income plays an important role. Want to assess your options? Please contact us today.