Manulife Investment Management

Refresh your *income playlist*

Have you ever listened to songs from your music playlist and thought, “Not again!”? If you have experienced this, you are probably showing signs of fatigue. The same analogy can be used for income-seeking investors who are exploring opportunities beyond their current portfolios, typically comprising high-yielding equities and government bonds.

With rates expected to stay low for longer, where else can investors look to generate sustainable and consistent income?

The good news is that beyond your current universe, there may be other types of income-generating investments that might potentially meet your financial goals. It is therefore an opportune time to review and refresh your income playlist.

INVESTOR EDUCATION SERIES

1.

What constitutes an *income playlist*?

First, let us understand what "income" really means.

Income is a return that doesn't come from buying or selling assets. It can take the form of cash dividend, interest or coupon payments (these are the terms used for the money derived from different instruments) that you receive on a regular basis from the investments that you hold.

Sources of income

It is important to grasp a thorough understanding of the various sources of income, not just what you are familiar with (namely high-dividend equities and government bonds):

- Dividend income from equities
- Interest or coupon payment from bonds
- Dividend from hybrid securities (e.g. preferred securities[1])
- Dividend from Real Estate Investment Trusts (REITs), which by law must distribute their earnings to investors
- Income from mutual funds in the above-mentioned instruments offering dividend distributions

These sources of income can be obtained from multiple avenues, across both developed and emerging markets. The yield – which is essentially the annual income derived from an investment, expressed as a percentage of the investment's market value – can vary among different asset classes (see chart), depending on risk levels and the interest rate environment.

The asset classes in the chart below typically distribute income on a regular basis (either monthly, quarterly or semi-annually) during your investment holding period.

Yields per annum among different asset classes for the past 15 years[2]

Asset class	Typical range for yield per annum (%)
US Treasury	1-5%
Global equities	2-5%
Investment grade corporate bond	3-6%
Global REITs	4-8%
Preferred securities	5-7%
High yield corporate bond	5-9%

[1] Preferred securities are a hybrid of bonds and equities with features from both asset classes. Their bond attributes include a stated par value, regular interest payments and assigned credit ratings by rating agencies. Meanwhile, their common stock characteristics mean they can be perpetual or long-dated. Preferred securities also have a lower priority in capital structure than senior debt but have a higher priority than common stock. Issuers are usually large and highly regulated institutions and/or companies with high stable cash flows such as banks, utilities, and Real-Estate Investment Trusts (REITs).

[2] Source: Manulife Investment Management, Bloomberg, as of March 2019. Typical yield per annum is based on historical yields for past 15 years. US Treasury refers to 10-year US Treasury; Global Equities refer to MSCI World; Investment grade corporate bond refers to JPMorgan US Investment Grade; Global REITs refer to FTSE EPRA/NAREIT; Preferred securities refer to ICE BofAML Fixed Rate Preferred Securities Index; High yield corporate bond refers to JPMorgan Global High Yield Index. A positive distribution yield does not imply a positive return.

2.

Key considerations when constructing your *income playlist*

As every investment offers both risks and rewards, there is no right or wrong investment to include in your income playlist.

However, it is important to bear in mind that yields should not be the be-all-end-all criteria in your decision-making. After all, each source of income has its own risk-reward profile, and may not be suitable for everyone.

Here are some useful considerations:

Risk tolerance and income target: What is your risk appetite? Would you allocate more money to relatively more conservative investments in exchange for lower income? Or do you have a more aggressive personality to chase after higher income and take on more risks? Bear in mind that a higher yield target may increase your risk exposure.

Correlation among assets: In general, the lower the correlation between the price movements of the different assets in your portfolio, the lower the risks. A classic example is the relationship between bonds and equities which broadly tend to move in opposite directions.

Liquidity of assets: When and how quickly do you need your income?

Continuous review and timely adjustments: As yields, market conditions and your risk appetite change over time, it is important to review and rebalance your portfolio from time to time.

3.

Who needs an *income playlist*?

Regardless of your investment goals, there are always merits to keeping an updated income playlist, particularly if you are:

A retiree seeking to enhance your regular income

An investor looking to reduce your portfolio risks amidst all the market volatility

An investor targeting to generate potentially higher yields in the current low-rate environment

Not sure what investment instruments suit you? Please contact your Manulife financial advisor.

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