Thinking bigger—the power of multi-asset income investing

June 2023

The power of multi-asset income investing lies in tailored exposure to a range of different asset classes. Nimble, innovative investment can allow a portfolio to generate income in all market conditions and, crucially, maintain the potential for further capital appreciation.

Many investors take a one-dimensional approach to income investing, based broadly around a single asset class. However, a portfolio based on this philosophy is unlikely to deliver a persistent stream of stable income, due to its inability to capture attractive yield opportunities as they arise elsewhere. This is particularly true in times of heightened market volatility, when it becomes harder to generate reliable income streams, potentially leaving single-asset investors with insufficient income to meet their needs.

Prior to the global financial crisis (GFC) in 2008, income investors coveted the attractive yields available from high-quality bonds with relatively low risk attached. This thinking was linked to a long-standing rule that suggested retirees could withdraw 4% of their savings each year after adjusting for inflation, without eating into their capital. The strategy developed during a prolonged period of high inflation encompassing the 1990s when the average yield on the 10-year Treasury note was 7.1%.[1] Following the GFC, more than a decade of very low interest rates forced investors to look toward dividend-paying equities for yield,

Exhibit 1: Equity Dividends Grew in Influence Following The GFC, but Fixed Income Yields Have Improved Considerably in the Past 12 Months

January 1, 1990–April 1, 2023

Source: Macrobond. S&P500 Index and US 10-year Treasury yield used in the chart. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Past performance is not an indicator or a guarantee of future results.

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effectively switching their focus from one asset class to another. During this period, there were several years in which a significant number of S&P 500 companies had higher yields than 10-year Treasuries.

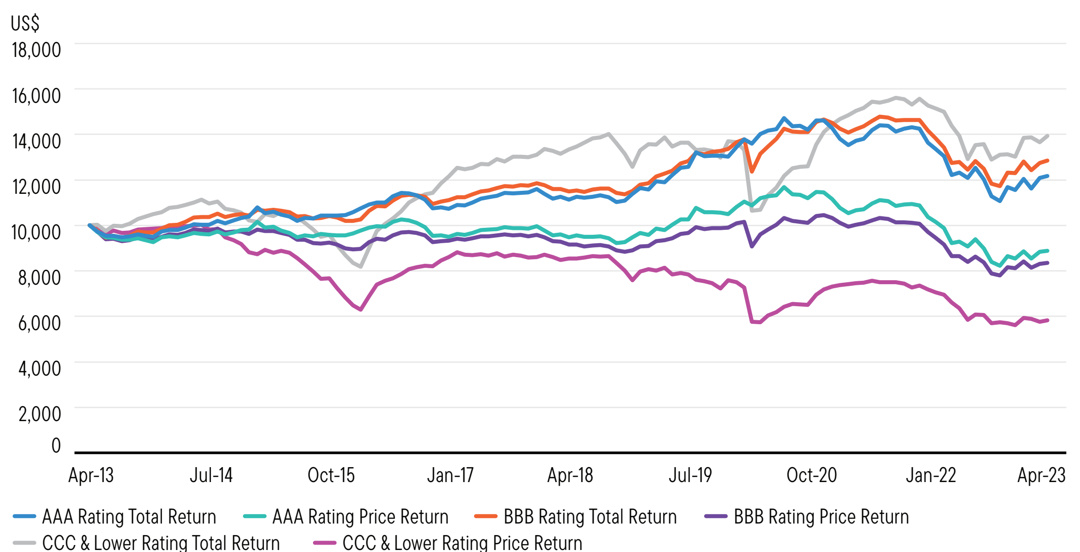
The recent period of post-pandemic monetary policy tightening has created a more volatile environment for all asset classes. Amid slowing growth and an uncertain economic outlook, an extended period of structurally higher inflation seems very likely in developed market economies, meaning interest rates will remain elevated, if not as high as they were in the latter part of the 20th century. While higher interest rates are a welcome element in income-oriented portfolios, higher inflation alongside higher volatility across all asset classes poses some difficult questions around portfolio construction. Inflation can reduce the value of capital, while frequent market drawdowns can make income withdrawals more costly, as dollar-cost averaging impairs value during a rebound.

The good news is that volatile markets also expand the income-generation opportunities available for savvy investors. We believe that diversifying exposure across multiple areas of risk, including credit, equity and interest rates, can allow risk-adjusted yields to be maximized and investors' income goals to be met. Monetary policy normalization has made this possible, but it requires a dynamic and flexible approach to portfolio construction, in which a broad range of investable yield-bearing assets are analyzed. This ensures that capital remains fluid, ready to be redeployed between assets.

As an example, the recent steep rise in interest rates across developed economies has increased the yield available from low-risk, cash-like assets. Many investors are likely tempted to concentrate their portfolio in these instruments, influenced by the perception of healthy yields, but rising rates have also pushed up yields on long-duration government bonds, which offer the added advantage of capital appreciation in the event of a downturn. Elsewhere, rising rates have impacted credit, creating attractive income-generation opportunities within the capital structure of companies. Yields of around 5% to 6% can currently be generated from investment-grade corporate bonds and closer to 9% from high-yield issues. On a risk-adjusted basis, these yields can be more attractive than those achievable at the risk-free rate, regardless of a more uncertain market outlook. The positive impact on total returns over time is also significantly enhanced.

Exhibit 2: The Impact of Bond Yields on Total Returns

As of April 30, 2023



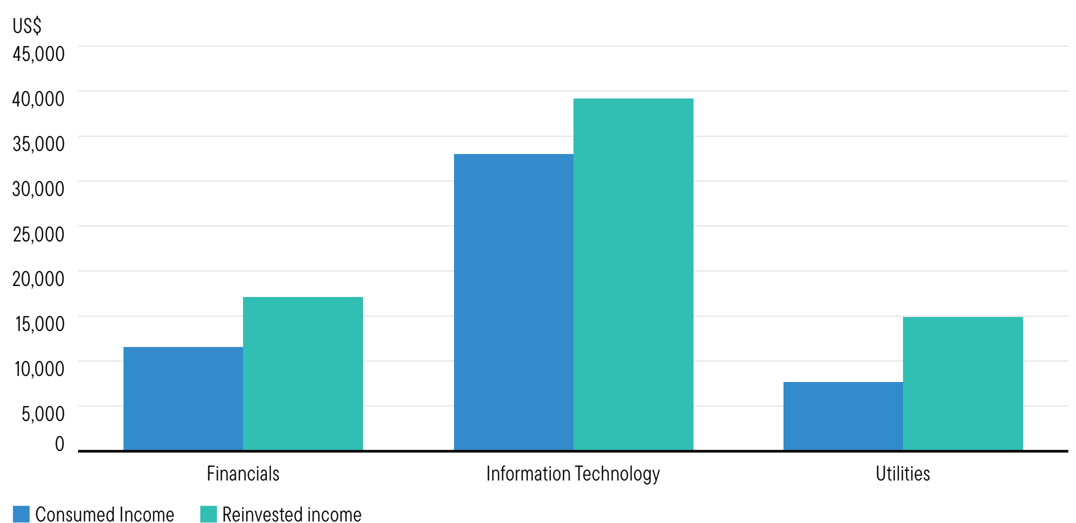
Note: The value of $10,000 invested in 2013 over a 10-year horizon.

Source: Bloomberg. ICE BofA Indices used in this chart. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Past performance is not an indicator or a guarantee of future results.

Another example highlighting the importance of diversifying risk can be found in the equity space. We believe stocks appear less attractive now than they have in recent years, given high interest rates and slowing global growth. We expect corporate earnings across the rest of 2023 and into 2024 to be flat to slightly negative, as companies find it increasingly difficult to generate growth, revenues start to fall, and higher costs weaken margins. This information might encourage income investors to move away from stocks in search of yields elsewhere. However, keeping elements of a portfolio in dividend stocks is advisable, in our view, given the potential for capital appreciation, alongside the powerful effect of dividend reinvestment. The average dividend contribution to S&P 500 total returns between 1940 and 2022 was 39%.[2] When these dividends are reinvested into equities, it creates a meaningful compounding effect, improving the ability of a portfolio to achieve more dividends and greater capital appreciation. A US$10,000 investment in the S&P 500 Index in 1993 was worth US$87,504 by 2022 without reinvesting dividends compared to US$157,121 with reinvestment—a difference of approximately US$70,000.[3]

Exhibit 3: The Impact of Equity Dividend Reinvestment

As of April 30, 2023



Note: The value of $10,000 invested in 2013 over a 10-year horizon.

Source: Macrobond. S&P 500 Equal Weighted Utilities Index, S&P 500 Equal Weighted Financials Index, S&P 500 Equal Weighted Information Technology Index used in this chart. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Past performance is not an indicator or a guarantee of future results.

Multi-asset investing is powerful because it allows well-managed portfolios to access a broad range of asset classes and securities, including the full breadth of the corporate capital structure. Tailoring exposure to a variety of investments in a nimble, innovative and flexible way can allow a portfolio to generate income in all market conditions and, crucially, maintain the potential for further capital appreciation.

Endnotes

1. Source: Macrobond. As of April 2023.
2. Ibid.
3. Ibid.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal. The value of investments can go down as well as up, and investors may not get back the full amount invested.

The positioning of a specific portfolio may differ from the information presented herein due to various factors, including, but not limited to, allocations from the core portfolio and specific investment objectives, guidelines, strategy and restrictions of a portfolio. There is no assurance any forecast, projection or estimate will be realized.

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Bond prices generally move in the opposite direction of interest rates. Thus, as the prices of bonds in an investment portfolio adjust to a rise in interest rates, the value of the portfolio may decline.

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