

JANUARY 2024 For institutional, professional and wholesale investors only

A 'SUFFICIENT INCOME FOR LIFE'

The Martin Currie Australia (MCA) Equity Income strategy invests in a diversified portfolio of high-quality companies.

The strategy aims to deliver a growing income stream through:



A 'sufficient income for life' focus – Unique investment approach aligns stock selection and portfolio construction with the income needs of retirees



Income-focused return profile – Favouring high quality, highly franked dividend payers to reduce income shocks and grow income



Benchmark unaware portfolio construction – Low security and sector concentrations to provide income diversification so no single stock dominates



Fundamental active ownership – Purposeful engagement with companies and client advocacy through proxy voting



Experienced stock pickers with long term track record – Deep industry experience generating 'active insights'

Read more in the following document about how the MCA Equity Income strategy seeks to provide the attributes of a 'sufficient income for life'.

Overview

The old view of the behaviour of retirees is that when they retire they automatically become more risk adverse and should move away from growth-style assets and more towards defensive assets.¹ We do not agree.

Income investors face challenges from the current global environment, leaving few sound options for higher income. Equity-based high-income options each have their shortfalls and can often make investors feel uncomfortable about being exposed to growth assets.

We believe that not all equities are created equal, and we have put the income needs of clients at the heart of the product design for the MCA Equity Income strategy. This has resulted in a portfolio that looks very differently to both traditional equities and other income-focused approaches.

Our income approach is premised on the philosophy that high-quality companies that have solid earnings can sustain dividends, match rises in the cost of living and are likely to be less volatile than the wider equity market. These are key attributes of what we like to call a 'sufficient income for life'.

Our experienced investment team is solely focused on identifying investment opportunities using a disciplined and repeatable investment approach based on proprietary research into **Valuation**, **Quality**, **Direction** and **Sustainable Dividends**. Stewardship is a critical element of our investment philosophy, and our Active Ownership approach, which includes ESG integration, engagement and voting, has been embedded directly into our investment process since 2009.

We have also long believed that maximising income and minimising risks such as impaired income, concentration and inflation, is a much more important risk measure than benchmark relative alpha and tracking-error measures. As such we believe that the traditional approach to thinking about benchmark relative risk may not be appropriate in income focussed portfolios.

Our benchmark unaware portfolio construction, with low security and sector concentrations, avoids income shocks, and provides greater diversification across economic sectors, helping to hedge against rising inflation/cost of living. To improve capital growth, we also avoid income enhancement derivative strategies. We have also designed the strategy to aim to extract the full benefit of franking credits and maximise after tax income for 0% tax payers.

We have over 10 years of experience in managing income strategies through very varied market cycles, including the COVID-19 impacted 2020, and we believe this shows that our unique methodologies can provide investors with a portfolio with the attributes of 'sufficient income for life'.

We believe that there are few peer strategies available in the market that address income in the way that the MCA Equity Income strategy can.



"A sufficient income for life"

- An **income stream** to support annual expenses
- **Income growth** for inflation protection
- **Capital growth** to manage longevity risk
- **Diversified growth** exposures (across a full asset allocation) to reduce income sequencing risk

Income focussed investment process

We have found that stocks that 'pass the grade' for traditional equity accumulation funds may not be suitable for income portfolios. The overarching belief for all of our income-focused strategies is that companies that have solid earnings can sustain dividend pay-outs and are likely to be less volatile than other stocks. Even in times of market volatility, such companies are expected to continue paying dividends and provide regular income.

The MCA Equity Income investment process starts with bottom-up fundamental research by our specialised industry analysts. The importance we place on proprietary research into long-term normalised earnings power, cashflow sustainability, business quality and risk, is reflected in the size, quality and experience of our investment team.

Our analysts' independent insights are captured in a consistent manner via MCA's proprietary research lenses. This creates a common language for expressing our views on the risks and opportunities across the investment universe.



Valuation

Fundamental insights into normalised earnings and risk to determine fair value



Direction

Fundamental insights into the direction of earnings changes

Quantitative assessment of short- and long-term factors such as:

- price momentum
- earnings revisions
- accruals



Quality

Fundamental insights into:

- business strength
- management and governance quality
- Sustainability (including considerations of modern slavery and human rights risks, contribution to the UN Sustainable Development Goals and other relevant factors.)

Quantitative risk rating based on:

- The MCA Analyst **Quality**
- Leverage
- Predicted beta
- Profitability



Sustainable Dividend

Fundamental estimate of a company's ability to maintain payments to shareholders through different stages of the cash flow cycle

Our analysts and portfolio managers are also supported by the MCA research platform through access to:

- a deep 'Active Ownership toolkit', that includes ESG-specific tools that the team uses to uncover material ESG risks and opportunities within their bottom-up fundamental research;
- big picture analysis to identify changing economic and market conditions that drive factor performance;
- a peer review process that builds collaboration and consistency;
- investment process R&D into new or refined alpha and risk signals; and
- proprietary real-time cloud based analytics.

Consideration of ESG factors in the investment process

ESG research is integrated deeply into MCA's multi-lensed research process and also our portfolio construction.

Our experience has demonstrated to us that ESG analysis, engagement and voting should be done by those making investment decisions rather than being outsourced as they are best positioned to develop an informed view of the ESG risks, opportunities and impacts that companies face or create. Therefore, this responsibility lies directly with our experienced team of research analysts and portfolio managers.

Drawing from our extensive experience, we've come to understand that engagement is an ongoing, iterative process that demands both patience and a persistent effort yielding results that unfolds over time. Our investment team's long-term experience with management engagements bolsters our ability to effectively affect company level changes. We have cultivated strong relationships and established open dialogues giving us the opportunity to express any areas of concern and encourage greater transparency on their management of these risks.

By incorporating material and relevant ESG factors that we have uncovered through our bottom-up fundamental research and engagement activities directly into the **Quality** and **Valuation** lenses, the investment process specifically reflects how ESG factors can increase or reduce the risk of companies delivering the normalised earnings, cashflows that our analysts forecast.

For further information on our embedded ESG process, please refer to our Active Ownership brochure on our [website](#).

Strategies to maximise a 'sufficient income for life'

In line with our belief that not all equities are created equally, we set out to build our Equity Income portfolios from the bottom up, and employ unique benchmark-unaware methodologies which seek to maximise a 'sufficient income for life' for our clients.

This results in a portfolio that looks very different to both traditional equities and other income-focused approaches.

We outline some of the key characteristics below.



1. Resilient dividends

When a company pays a very high dividend that cannot be sustained, and then ends up cutting it, it can create an income shock to the dollar income level of the portfolio as a whole. And if sold out automatically after the yield fell, it can also result in an impaired capital value despite maintaining a steady headline yield.

In portfolio construction we place great importance on a stock's **Sustainable Dividend**, rather than a current or consensus dividend.

As part of their fundamental research, our team of analysts assesses each company's dividend paying power by analysing free cash flow generation through different stages of the economic cycle and explicitly modelling a two-year bear case scenario, i.e., can a dividend be paid in 8 out of the next 10 years, rather than the "worst case" dividend, because that is always going to simply be zero for every company. The advantage of our 8/10 approach is it allows us to consider a significant downside scenario for each company and what level of dividend they can pay in a crisis.

Our downside scenario analysis also includes higher interest rates and inflation; our process therefore has a strong preference for owning stocks that can deliver on our income growth objectives even in a rising interest rate environment.

By investing in stocks with the most attractive **Sustainable Dividends**, the dividend component of a stock's total return is more stable, thus providing lower income volatility and more certainty in the dollar income amount no matter what the capital gains or losses may be for a stock.



2. A focus on Quality

High Quality companies tend to generate high free cash flows, which in turn generate attractive **Sustainable Dividends** as discussed above. Payout ratios alone are not a good indicator of sustainability, and our analysts fundamentally assess the free cash flow generation of companies through different stages of the economic cycle and look through any financial engineering that may artificially boost headline or near-term dividends.

As part of their stock research, our analysts assess each company's **Quality**. We deeply understand that ESG factors can lead to an increased or reduced risk of companies delivering the normalised earnings that our analysts have forecast. These factors are reflected by the way Sustainability is an important part of our overall assessment of **Quality**.

We use a 1-5 scale, with lowest quality 5 rated stocks excluded completely from the investable universe. We have found that screening out stocks with lower quality and skewing towards higher quality stocks results in a portfolio that has naturally less volatile income than the market, i.e., less income shocks when a dividend that cannot be sustained ends up being cut.



3. Maximising franking credits

While it is often said there is no free lunch in finance, franking credits for Australian retirees could be considered a free lunch as the market values franking at a tax rate above the retirees 0% rate.

We recognise the value of franking credits within our investment process. As such, we seek to maximise the after-tax income for 0% taxpayers by actively selecting companies that both have a high rate of franking, and pay sustainable dividends.

The MCA investment process formally values franking credits and penalises unfranked dividends in the **Valuation** process, and therefore franking is a driver of every investment decision. We also avoid wash sales to protect franking credits and our pre-trade compliance flags any security that we are about to sell within 45 days of purchase, so that we can avoid loss of franking credits under the 45-day rule.

Global equities, on the other hand, incur withholding taxes, and thus miss out on the franking credit free lunch.

This differentiated source of return is also important because it allows more of the returns to come from a more stable income source than uncertain capital growth.





4. Avoiding over concentration

When you look at portfolio construction through an income lens, minimising the concentration risk within equity benchmarks (especially within the ASX) is more important than benchmark-relative alpha and tracking error measures.

We use a non-benchmark portfolio construction approach to limit security and sector concentration risk, and we believe this helps to ensure a more stable income stream and avoid income shocks in any one stock.

We promote diversification by focusing on a low absolute concentration of security and sector weights. We limit individual securities to a maximum 6% of the portfolio, meaning the portfolio's total yield is not dominated by any one security. We also limit the portfolio to a maximum of 22% in any one economic sector. These limits mean that the portfolio is structurally underweight the Top-20 ASX stocks, one of the most concentrated markets in the world. From a sector view, the index is dominated by banks and metals & mining sectors, which are typically volatile dividends.

Due to the concentrated nature of the Australian market, typically Australian benchmarks are not actually a very good mirror of the effect that Australian inflation has on long-term income requirements. Therefore, we have structured our portfolios to have better diversification across the domestic economy, in sectors such as consumer, financials and real assets, and this means that they have income growth more correlated to income needs.



5. Avoiding capital impairments

Finally, we believe that an important way to improve or maintain capital growth is to not do anything unnecessary that could impair capital.

- Strategies that use derivatives to provide income enhancements or capital protection are in fact potentially detrimental to capital growth, and thus income growth, as the cost is borne from capital.
- Strategies that automatically sell stocks because of an income shock, such as rules based high yield ETFs, can result in an impaired capital value despite maintaining a steady headline yield.
- High turnover strategies also are more likely to impair capital due to excessive trading as they are turning capital to income by constantly moving to the next dividend paying stock.

Our income strategies do not use derivatives, are fully active, and are designed to be low turnover. We also seek a significant spread between the **Valuation** and **Sustainable Dividend** signal of securities we are trading to provide a buffer to ensure that trading is necessary.



The MCA investment team

The MCA Equity Income strategy is managed by Reece Birtles, Chief Investment Officer & Portfolio Manager, and Michael Slack, Portfolio Manager & Head of Research. Reece Birtles has ultimate management responsibility for the Equity Income strategy.



Reece Birtles

Chief Investment Officer
& Portfolio Manager



Michael Slack

Portfolio Manager
& Head of Research

The Equity Income investment process draws on a wide range of proprietary fundamental and quantitative research metrics, and the strategy benefits from the close collaboration of the well-resourced and experienced MCA investment team.



**Deep industry expertise
generating best ideas**



**A learning culture and
growth mindset**



**Highest standard of
professional conduct**



**Passion for investment
excellence and focus on risk
management**

- MCA team of 17 led by Chief Investment Officer Reece Birtles
- Average tenure of 14 years, average industry experience of 22 years - across a variety of industry backgrounds¹
- Additional insights from broader Martin Currie global investment floor
- Investment expertise and rigour gained through peer review
- Key focus on continuous development and improvement
- Team culture, built on coaching and mentoring
- Living the values of investing to improve lives through the responsible management of our own business
- Consistent investment philosophy and process applied to an extensive range of investment products
- Tailored investment options aligned to client needs
- Sophisticated, interactive risk analysis
- Robust risk culture

¹As of 31 December 2023.



Key facts

| | |
|-----------------------|---|
| Launch date | 22 May 2010 |
| Performance objective | The strategy aims to provide an after-tax yield above the S&P/ASX 200 Index yield and to provide an income stream growth above inflation |
| Benchmark | No formal benchmark |
| Investable universe | Australian listed securities / all-cap |
| Number of securities | Typically 45 |
| Security limits | Absolute 6% |
| Sector limits | Absolute 22% |
| Portfolio turnover | Typically 25% p.a. |
| Tracking error | We do not target tracking error, but total risk outcome is typically 90% of the market |
| How to access | Segregated mandate Martin Currie Equity Income Fund (An Australian Unit Trust) BetaShares Martin Currie Equity Income Fund (managed fund) ASX: EINC |

The characteristics shown are guidelines only and are not hard risks limits.

Industry recognition

Signatory of:



Since 2009

Latest PRI Rating¹



Policy governance
and strategy



Confidence
building measures



Direct – Listed equity
– Active fundamental

Top quartile

Ranking vs peers
across all three pillars²



Holder of highest Morningstar
Sustainability Rating^{TM3}

¹Source: Martin Currie and PRI 2022. Ratings relate to the period 1 January 2022 – 31 December 2022.

Martin Currie has been awarded the highest possible rating from the Principles of Responsible Investment (PRI), with a five-star rating across all categories relevant to its investment activities. A copy of the PRI's assessment and transparency report are available on our [website](#).

²Policy governance and strategy: 95%; Direct – Listed equity – Active fundamental: 100%; Confidence building measures: 100%

³Sustainability Score and Sustainability Rating as of 30 November 2023. Data based on Martin Currie Equity Income Fund. Sustainalytics provides issuer-level ESG Risk analysis used in the calculation of Morningstar's Sustainability Score. Based on 96% of AUM. Data is based on long positions only.

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About Martin Currie Australia



A leading innovator of **Australian Equity, Real Asset and Multi-Asset strategies**



Specialist investment manager
of **Franklin Resources Inc.**



40+ years in
Australian equities



World class
ESG credentials*



Tailored investment options
aligned to client needs



17 member team of
specialist investment analysts



A\$6 billion in
Australian equities

Source: Martin Currie, as at 31 December 2023.

For further information on our market leading ESG credentials please refer to full details on our website:
www.martincurrie.com/our-story/our-stewardship-approach



Important information

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Past performance is not a guide to future returns.

The distribution of specific products is restricted in certain jurisdictions, investors should be aware of these restrictions before requesting further specific information.

The views expressed are opinions of the portfolio managers as of the date of this document and are subject to change based on market and other conditions and may differ from other portfolio managers or of the firm as a whole. These opinions are not intended to be a forecast of future events, research, a guarantee of future results or investment advice.

Some of the information provided in this document has been compiled using data from a representative account. This account has been chosen on the basis it is an existing account managed by Martin Currie, within the strategy

referred to in this document. Representative accounts for each strategy have been chosen on the basis that they are the longest running account for the strategy. This data has been provided as an illustration only, the figures should not be relied upon as an indication of future performance. The data provided for this account may be different to other accounts following the same strategy. The information should not be considered as comprehensive and additional information and disclosure should be sought.

The analysis of Environmental, Social and Governance (ESG) factors forms an important part of the investment process and helps inform investment decisions. The strategy/ies do not necessarily target particular sustainability outcomes.

Risk warnings - Investors should also be aware of the following risk factors which may be applicable to the strategy shown in this document.

- Investing in foreign markets introduces a risk where adverse movements in currency exchange rates could result in a decrease in the value of your investment.
- This strategy may hold a limited number of investments. If one of these investments falls in value this can have a greater impact on the strategy's value than if it held a larger number of investments.
- Smaller companies may be riskier and their shares may be less liquid than larger companies, meaning that their share price may be more volatile.
- Income strategy charges are deducted from capital. Because of this, the level of income may be higher but the growth potential of the capital value of the investment may be reduced.

For wholesale investors in Australia:

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