STRATEGY **GUIDE**

Martin Currie Australia
Ethical Income

MARTIN CURRIE
A Franklin Templeton Company

JANUARY 2024 **For institutional, professional and wholesale investors only**

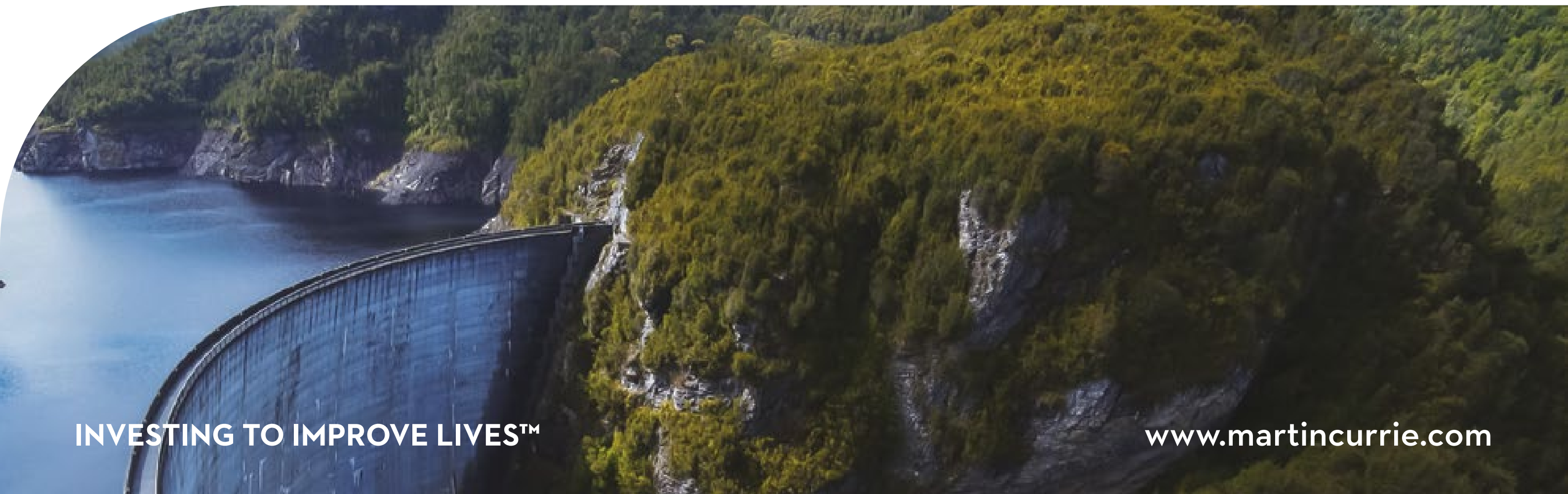
COMBINING CLIENT VALUES WITH A ‘SUFFICIENT INCOME FOR LIFE’

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

The strategy aims to deliver a growing income stream, through:

- **No binary choice between client values and returns –** Unique investment process that reflects client ethical values without compromising income objective of providing a **‘sufficient income for life’**
- **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 Ethical Income strategy seeks to provide a ‘sufficient income for life’, without making investors choose between income returns and their values.



Overview

Investors don't want to have to choose between income and their values – and we believe they shouldn't have to.

We have put the income needs of clients, and their values, at the heart of the product design for the MCA Ethical Income strategy.

The MCA Ethical Income strategy was launched in December 2015, with the aim of providing investors – such as charities, foundations and not-for-profit organisations – with an ethically screened version of our high-quality, lower-risk Australian Equity Income investment option.

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.

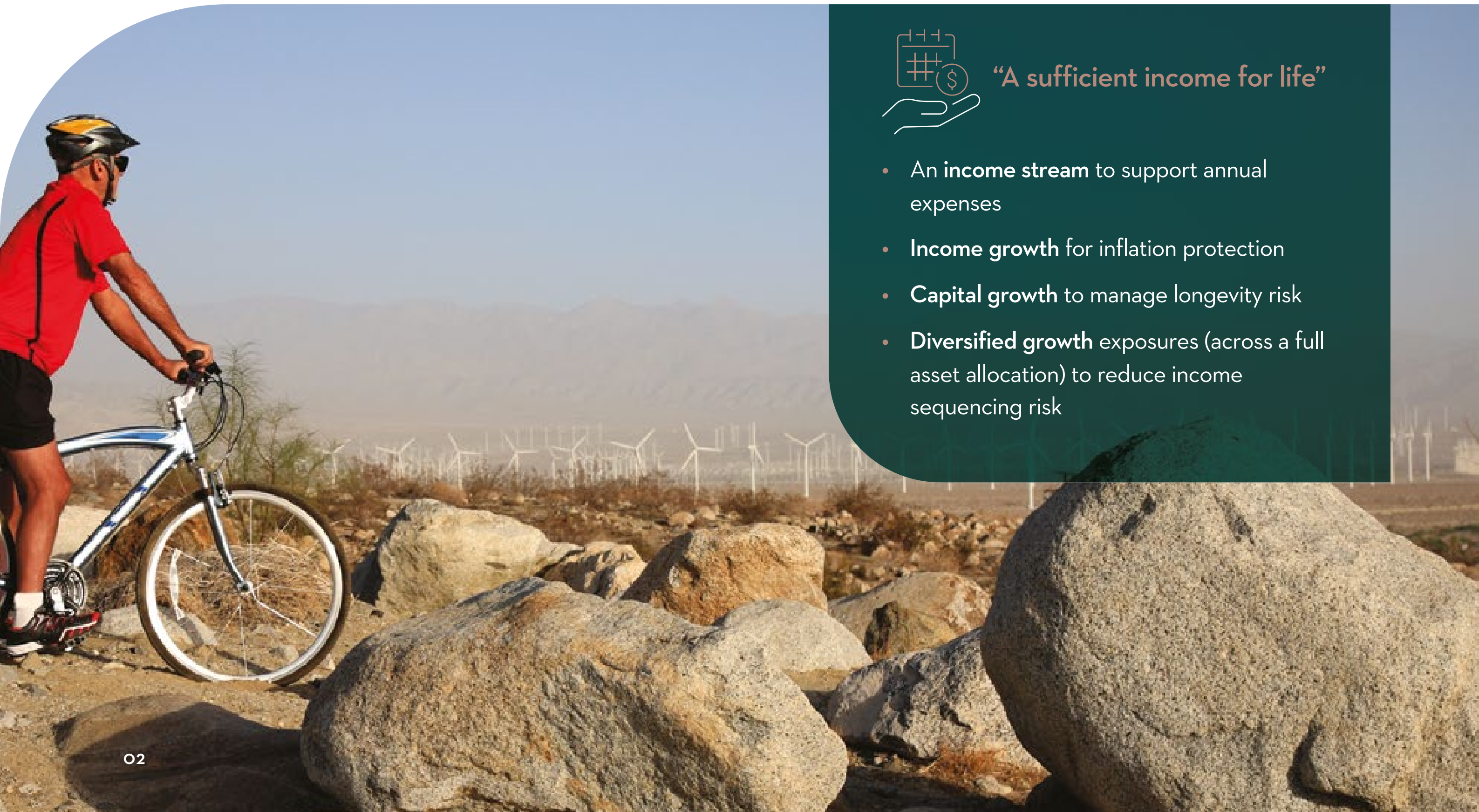
ESG research based on MCA's proprietary assessment of a company's governance management and sustainability, is integrated deeply into our investment process. We incorporate negative ethical values and further ESG exclusions based on client-specific requirements. Through our experience, we have found that the inclusion of a client's own ethical values has been complementary to our focus on high-quality companies, and thus has not compromised the objective of aiming to provide a high, stable and growing income stream.

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, thus avoids income shocks, and provides greater diversification across economic sectors, helping to hedge against 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 both income and client values in the way that the MCA Ethical 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 Ethical 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	Direction	Quality	Sustainable Dividend
Fundamental insights into normalised earnings and risk to determine fair value	Fundamental insights into the direction of earnings changes Quantitative assessment of short- and long-term factors such as: • price momentum • earnings revisions • accruals	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	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, engagement and proxy voting 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.

- Where material to a company's ability to generate long-term returns, we factor the cost/benefits of ESG inaction or action directly into our **Valuation**.
- The materiality of ESG risk factors is reflected in our Management, Governance and Sustainability ratings, which feed into our overall assessment of **Quality**. **Quality** is also used as a component in the stock-specific discount rates used in our **Valuation** model.

As a result, the combination of **Quality** and **Valuation** adjustments can tilt our assessment of fair value on these stocks, and ESG factors can directly impact the size of an individual security position in a portfolio, or our decision to invest in, or divest from these stocks.

For further information on our embedded ESG process, please refer to our Active Ownership brochure on our ***website***.

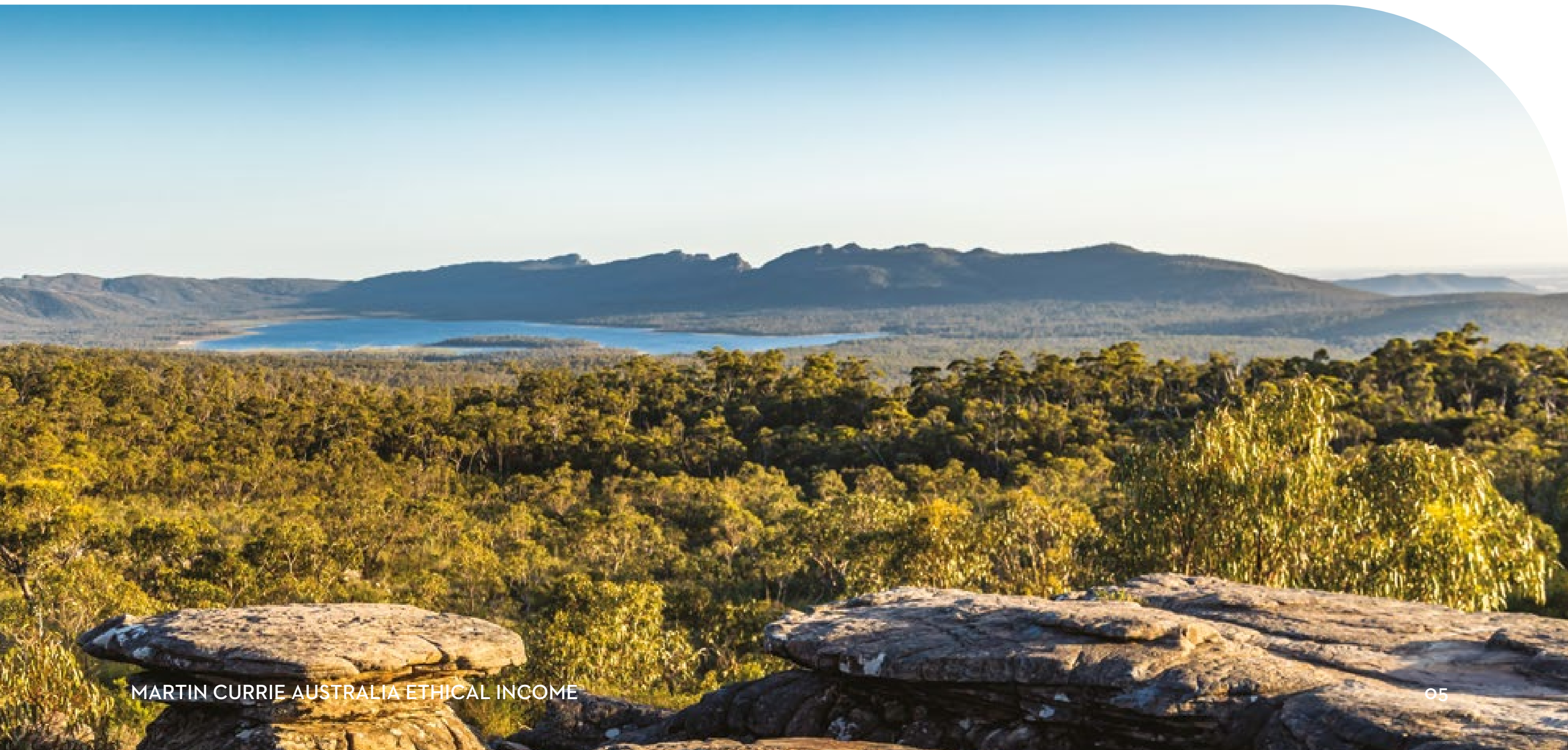
Negative ethical screens

We actively screen out companies that do not meet the strategy's ethical investment criteria to ensure the portfolio does not invest in securities with excluded business activities. Should an investment cease to be consistent with these screens, we would divest as soon as reasonably practicable and in the best interests of investors.

The criteria for determining our ethical screens has been drawn from working with third-party vendors, charities and foundations on their investment requirements. The criteria for the screens are expected to be static in nature; however, they can be adjusted over time to fit with market norms and market demand, and also client specific requirements.

The screens consist of the following criteria:

- Companies with revenues related to any one of the following activities that represent more than 5% of the company's total revenue, or revenues from a combination of any of the following activities that represent more than 10% of the company's total revenue:
  - Alcohol
  - Adult entertainment
  - Tobacco
  - Fur
  - Gambling
  - Genetically modified crops
  - Nuclear power
- Companies with revenues related to any one of the following activities that represent more than 5% of the company's total revenue, or revenues from a combination of any of the following activities that represent more than 10% of the company's total revenue:
  - mining, extraction, refinement, transportation, distribution, and power generation from thermal coal
- Companies directly involved in:
  - the production of controversial weapons
  - the manufacture of tobacco products
- Companies that do not meet MCA's assessment of Modern Slavery (including child labour)
- Companies that, in the opinion of Martin Currie Australia are not operating in accordance with widely accepted international norms and principles, including the:
  - Universal Declaration of Human Rights
  - International Labour Organisation (ILO) Declaration on Fundamental Principles and Rights at Work
  - United Nations Global Compact
  - United Nations policy on trafficking in humans
  - the OECD Guidelines for Multinational Enterprises
  - the Catholic Health Australia Code of Ethical Standards.



Additionally, we provide screens based on the Catholic Health Australia Code of Ethical Standards (the 'Code'). This is currently implemented for the Australian-domiciled Martin Currie Ethical Values with Income Fund.

In order to implement this more subjective screen, we have carefully considered each aspect of the Code (for example views on performing abortions or live embryo research) and have used revenue data and our own research to determine if any company within our investible universe has a direct exposure.

Due to our emphasis on **Quality** and **Sustainable Dividends**, very few stocks in our investment universe that pass the grade for our traditional Equity Income portfolios are excluded by the Ethical and ESG Impact screens. This reflects our belief that our 'sufficient income for life' focus is already complementary to the income needs of an ethical investor.

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 Ethical 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 though 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 25% 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 Ethical Income strategy is managed by Reece Birtles, Chief Investment Officer & Portfolio Manager, and Will Baylis, Portfolio Manager. Reece Birtles has ultimate management responsibility for the Ethical Income strategy.

Reece Birtles
Chief Investment Officer
& Portfolio Manager

Will Baylis
Portfolio Manager

The Ethical 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

- 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 backgrounds[1]
- Additional insights from broader Martin Currie global investment floor

A learning culture and growth mindset

- Investment expertise and rigour gained through peer review
- Key focus on continuous development and improvement
- Team culture, built on coaching and mentoring

Highest standard of professional conduct

- Living the values of investing to improve lives through the responsible management of our own business

Passion for investment excellence and focus on risk management

- 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

[1]As of 31 December 2023.

Key facts

Launch date	8 December 2015
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 / companies that pass the ethical criteria
Number of securities	Typically 40
Security limits	Absolute 6%
Sector limits	Absolute 25%
Exclusions	See page 4
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 Ethical Values with Income Fund (An Australian Unit Trust)

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

Industry recognition

Signatory of:

PRI Principles for Responsible Investment

Since 2009

Latest PRI Rating[1]

★★★★★
Policy governance and strategy

★★★★★
Direct – Listed equity – Active fundamental

★★★★★
Confidence building measures

Top quartile
Ranking vs peers across all three pillars[2]

Holder of highest Morningstar Sustainability Rating™[3]

[1]Source: 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*.

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

[3]Sustainability Score and Sustainability Rating as of 30 November 2023. Data shown for the Martin Currie Ethical Values with Income Fund. Sustainalytics provides company-level analysis used in the calculation of Morningstar's Sustainability Score. Based on 99% of AUM. Data is based on long positions only.

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

This information is issued and approved by Martin Currie Investment Management Limited ('MCIM'), authorised and regulated by the Financial Conduct Authority. It does not constitute investment advice. Market and currency movements may cause the capital value of shares, and the income from them, to fall as well as rise and you may get back less than you invested.

The information contained in this document has been compiled with considerable care to ensure its accuracy. However, no representation or warranty, express or implied, is made to its accuracy or completeness. Martin Currie has procured any research or analysis contained in this document for its own use. It is provided to you only incidentally and any opinions expressed are subject to change without notice.

This document may not be distributed to third parties. It is confidential and intended only for the recipient. The recipient may not photocopy, transmit or otherwise share this [document], or any part of it, with any other person without the express written permission of Martin Currie Investment Management Limited.

This document is intended only for a wholesale, institutional or otherwise professional audience. Martin Currie Investment Management Limited does not intend for this document to be issued to any other audience and it should not be made available to any person who does not meet this criteria. Martin Currie accepts no responsibility for dissemination of this document to a person who does not fit this criteria.

The document does not form the basis of, nor should it be relied upon in connection with, any subsequent contract or agreement. It does not constitute, and may not be used for the purpose of, an offer or invitation to subscribe for or otherwise acquire shares in any of the products mentioned.

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.

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:

Any distribution of this material in Australia is by Martin Currie Australia ('MCA'). Martin Currie Australia is a division of Franklin Templeton Australia Limited (FTAL), (ABN 76 004 835 849). Franklin Templeton Australia Limited is a wholly owned subsidiary of Franklin Resources, Inc., and holds an Australian Financial Services Licence (AFSL No. 240827) issued pursuant to the Corporations Act 2001.

MARTIN CURRIE
A Franklin Templeton Company

Martin Currie Investment Management Limited, registered in Scotland (no SC066107)
2nd Floor, 5 Morrison Street, Edinburgh EH3 8BH
Tel: (44) 131 229 5252 Fax: (44) 131 228 5959 **www.martincurrie.com**
Please note that calls to the above number and any other communications may be recorded.