

A guide to income in a low-yield environment

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As the world experiences low nominal growth and investors brace for a global and long-lasting “Japanification” of economies, the hunt for income is intense.



Michalis Ditsas
Investment Specialist

Since 2018, developed economies have experienced a growth slowdown, with the US expected to expand at approximately 2% and Europe and Japan at less than 1%. Emerging markets are not immune from this trend as global trade tensions, slowing demand for commodities and poor demographic dynamics result in subdued productivity gains.

Industrial activity has also contracted globally since 2018 alongside business confidence, which in Germany is at post-crisis lows. Inflation continues to be well below target and trends lower for most developed and some EM economies. Moreover, inflation is expected to remain low for longer due to structural factors such as technology, the rising share of services in economies and high levels of indebtedness. This is despite the fact that base-effects along with technical and seasonal factors all suggest that inflation is bottoming-out in developed economies.

In this context, central banks had to cut interest rates, performing a u-turn from just a year ago when they attempted to end quantitative easing programmes and raise rates. Arguably, monetary policy has reached its limits, especially in Europe and Japan, where central banks have little-to-no room left for manoeuvre. The Fed has more flexibility, but it's questionable for how long. The only reasonable conclusion is that fiscal stimulus will be needed next time a downturn occurs, as recently indicated by Mario Draghi.

On the positive side, we see no slowdown in the service sector, which represents a continuously growing 65-75% share of Gross Domestic Product in developed economies and China. In addition, household consumption remains firm as unemployment is low and trending lower, the value of assets is not decreasing and affordable financing is available. It's worth noting that for now, household consumption more than offsets the weakness in industrial activity and capital spending. This will continue to be the case until employment is impacted by negative business sentiment, asset values decline (in real estate or equity markets) or an exogenous inflationary shock (higher oil prices, tariffs...) impacts real purchasing power.

In this low growth world, we design portfolios that target income in a diversified and risk-controlled manner, using all available opportunities to improve returns. Within this context, in fixed income we currently favour high quality government bonds (mainly in the U.S. but also some Italian exposure), EUR credit vs. USD (focusing on European subordinated bonds) and finally, selected opportunities in Emerging Market hard currency bonds.

Within equities, we favour income strategies, with a focus on companies that adopt a disciplined approach toward paying dividends while still reinvesting in their business. Dividend strategies have tended to offer superior risk/reward over the long term, and we expect this phenomenon to continue. They also offer a very welcome source of yield.

It is important to highlight that these strategies are inherently more diversified than in the past. It is striking that over recent decades, the IT sector has almost quadrupled its role as a source of global dividends. At the same time, telecoms and utilities have plummeted almost two thirds by the same measure. Our approach to fully benefit from the virtues of equity income, while minimizing style biases, is to construct portfolios without focusing solely on the dividend level and avoid so-called value traps, without chasing growth at any price. A balanced mix of various sources of dividend payers offers the best risk-adjusted results.



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