

## Global Equity Income

Alan Porter, manager of the Martin Currie Global Equity Income fund

October 2011

Historically, British investors who want income from their equity funds have tended to focus on the UK market. It's easy to see why: domestic companies are well known and well understood, and their fortunes are easy to follow in the daily newspapers. People tend to trust what they know. This has led to a perception that domestic companies are the best choice for income-minded investors.

But in today's globalised world, that perception is misplaced. The case for a wider investment horizon has never been stronger. Given the global reach of many of the world's best companies, country-based limits look largely arbitrary, and countries of listing often represent no more than a 'flag of convenience'. So, in the developed world at least, a country's stockmarket is no longer a reflection of its economy. With global earnings streams and the increased importance of the major emerging markets, an international approach is becoming indispensable.

That's all the more true from an income perspective. Of the world's 100 highest-yielding companies, just 10 are listed in the UK. So a domestic fund cuts off 90% of the best high-income opportunities. Indeed, 13 other developed equity markets offer a higher dividend yield than the UK stockmarket. These include France, Germany, Switzerland, Spain, Portugal, the Netherlands and the Scandinavian countries, as well as Australia.

So, if you want income, you would do well to think globally. And you probably should be thinking about income even if capital growth is your primary aim. Despite what many investors believe, yield and growth are not mutually exclusive – far from it. Studies show that companies with higher payout ratios exhibit strong subsequent 10-year earnings growth. In fact, over the past 15 years, the highest-yielding companies (as represented by the MSCI High-Yield index) have outperformed the rest of the market (as represented by MSCI World) on both a capital-return and total-return basis. And the volatility of both indices was the same, so the risk/return ratio was better for high-yield stocks too.

All this highlights the fact that too many investment approaches make finding the best companies a terribly complex business. In fact, it's simple – look for those companies that can afford to return most cash to their shareholders. From the shareholder's perspective, those *are* the best companies. After all, historically, joint-stock companies were established specifically to pay dividends: that was the point. Our modern

obsession with capital returns has obscured this, but as the data shows, dividends remain a hugely important guide to the potential of a stockmarket investment.

In an ongoing environment of very low interest rates (in developed markets at least), it's also worth noting that high-yielding stocks currently compare very favourably with other asset classes, particularly government bonds. Yield spreads on corporate bonds are also still relatively narrow. And we should remember that any panic is essentially an overreaction – and every overreaction in the market throws up opportunities.

Those opportunities will be select rather than general. But they will be very real. Given a tentative and uncertain economic recovery in the developed world, firms with high-quality franchises, balance sheets and management should command a premium. So investors should always consider the best stocks, not the broad stockmarket. Picking the 'winners' will be especially important in the months and years ahead.

So, the best approach in these volatile times is to hunker down, screen out the day-to-day 'noise' and focus on the fundamentals of individual companies. Then, in cases where quality is evident, any short-term weakness should present excellent buying opportunities. Over the longer term, we should expect further outbreaks of panic to punctuate the next few years – at least until some lasting resolution is reached in Europe, the US addresses its fiscal deficit, and the global recovery finds a firmer footing. But we should also remember that the fierce competition in an environment of constrained growth will entail high stakes for companies – with the winners taking all.

**Important information:** The information given above has been issued and approved by Martin Currie Investment Management Limited (MCIM). MCIM is authorised and regulated by the UK Financial Services Authority ('FSA'). It does not in any way constitute investment advice nor is it an offer or an invitation to invest in any of our funds or appoint MCIM as investment manager. The information contained in this document has been compiled with considerable care to ensure its accuracy. But 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.