

WealthStyles

Income Series, Part 2 of 3

Where can I source additional income?

Key takeaways

- Apart from the familiar sources like equities and bonds, diverse range of income sources is also available in the market, such as income funds
- Examples of non-traditional income sources include Real Estate Investment Trusts (REITs), preferred securities, and options
- The amount of income you receive and how often it's paid may vary. Factors include the issuers' business performance, issuing terms, market conditions, and regulatory policies

There are many income sources to consider, each with different characteristics such as income volatility and risk levels. By gaining an in-depth knowledge of these, investors should be able to find suitable options to broaden their investment income.

Traditional income sources

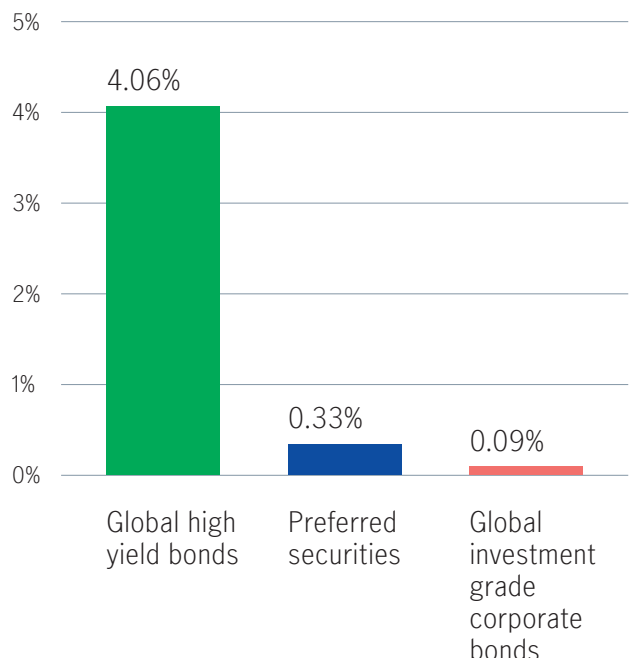
Income funds: These are mutual funds with payout characteristics that typically distribute dividends at regular intervals. Generally, the dividend yield is not guaranteed, but as is the case with any diversified portfolio, the likelihood of every holding simultaneously failing to distribute is small. Therefore, the chance for investors receiving no income is relatively low.

Non-traditional income sources









Real Estate Investment Trusts (REITs): REITs are legally obliged to distribute the majority of net income after tax as dividends. They cannot suspend payouts due to economic or business factors. As long as a REIT records positive net income, unit holders are entitled to dividend payouts.

Preferred securities: Preferred securities are hybrid securities with equity and bond characteristics. They are usually issued by large, tightly regulated institutions and companies, such as banks or utilities. The dividend yield is generally fixed. These entities typically have larger and more stable cash flows, enabling them to pay dividends. Their default rate is also lower than that of high-yield bonds.

Long-term average default rate (1990-2019)¹



Options: By selling a call option or put option, investors can receive a premium (income) in advance without waiting until the option expiry date. However, it should be noted that obtaining a premium does not necessarily mean that the overall investment return is positive. If the trend of the underlying asset deviates from expectations, i.e., the price of an asset actually rises after selling a call option, or vice versa, overall returns may be negative, as the premium may not be adequate to offset the loss on exercising an option completely.

 <p>Traditional income sources²</p>	 <p>Income funds</p>	<p>Payout frequency: Depends on the dividend policy of a fund. Some pay dividends on a monthly basis.</p> <p>Income volatility: Depends on the income generated by a portfolio's holdings</p>
	 <p>Equities</p>	<p>Payout frequency: Usually quarterly, semi-annually or annually</p> <p>Income volatility: Depends on a company's financial situation and/or the regulatory policies</p>
	 <p>Bonds</p>	<p>Payout frequency: Usually quarterly, semi-annually or annually</p> <p>Income volatility: Coupon rates vary according to bond type (e.g. government/ corporate bonds; fixed rate/ floating rate bonds), ratings, duration, and underlying assets (e.g. inflation-linked bonds)</p>
 <p>Non-traditional income sources²</p>	 <p>REITs</p>	<p>Payout frequency: Usually quarterly, semi-annually or annually</p> <p>Income volatility: Legally obliged to pay dividends, but it depends on the amount of distributable income</p>
	 <p>Preferred securities</p>	<p>Payout frequency: Usually quarterly, semi-annually or annually</p> <p>Income volatility: Paid at fixed rates</p>
	 <p>Options</p>	<p>Payout frequency: Premiums are received at the beginning of the investment period</p> <p>Income volatility: Depends on strike prices, expiry dates, and volatility</p>

¹ Source: Default rate of global high-yield bonds and global investment-grade bonds provided by Moody's Investors Service, Inc. Default rate of preferred securities during 1990–2017 calculated by Wells Fargo. As Wells Fargo stopped providing the relevant information after 2017, Manulife Asset Management has calculated the annual default rate based on the ICE BofAML US All Capital Securities Index since 2018. As of 31 December, 2019. Past performance is not indicative of future performance.

² The above material is for illustration purposes only. Distribution of dividends, the frequency of distribution and the amount/rate of dividends are not guaranteed. Positive distribution yield does not imply positive return.

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