

Philosophy and Process



Multi Asset Income

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All information is sourced from Baillie Gifford & Co and is current unless otherwise stated.

The images used in this document are for illustrative purposes only.



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Overview

The purpose of Multi Asset Income is to deliver the following to our clients over the long term:

- An attractive and resilient monthly income stream
- Preservation of income and capital in real terms

What we mean by attractive and resilient income

We aim to distribute the highest level of income which is sustainable and consistent with the long-term objective of maintaining capital value in real terms. We expect the income distribution to grow in line with inflation over time, as we recognise the importance of maintaining the purchasing power of our clients' income in the long term.

Although this level of income is likely to vary from time to time, given changes in prospective returns from the various assets in which we can invest and new opportunities which may arise in the future, our expectation is that the income distribution should be resilient to material declines. We manage the strategy with the aim of limiting any forecast decline in income to 10% on an annual basis.

We prioritise long-term sustainability of income in order to align with our clients' requirements for multi-year income streams. Therefore, we will not attempt to maintain an unsustainable level of income at the cost of a permanent loss of capital, which would reduce our ability to make future distributions (with this concept explored further in Appendix 2). We would, therefore, allow it to fall further than 10% should we believe it to be necessary for the achievement of Multi Asset Income's long-term investment objectives.

Approach to capital

Our aim is to grow capital in order to maintain its value in real terms over the long term, and the strategy invests in assets which can provide growth as well as income. As capital preservation is critical to support future income, we carefully manage risk through active asset allocation, security selection and hedging strategies.

Given the diverse nature of the assets in which the strategy invests, we also expect the volatility of total returns to be around one-half to two-thirds that of equities over the long term.

Forecast portfolio yield

3.3% net of all fees, expenses and taxes*.

*12 month forward yield at 31 December 2020.

Philosophy

Our investment philosophy is centred on the following core beliefs:

- **Diversification** brings resilience to income and capital, and a broad opportunity set is required to construct the best mix of assets to balance current and future income requirements
- **Active management** and a **focus on income**, in both asset allocation and security selection, are necessary to sustainably deliver our objectives
- **Capital preservation** is what supports future income payments and it must not be sacrificed in an attempt to support an unsustainable level of income
- **Good stewardship** and a focus on sustainability are essential, and helpful to long-term investment returns.

Key features

Breadth

The strategy invests across a range of asset classes including equities, government and corporate bonds, emerging market debt, property and infrastructure. The benefits of diversification and flexibility in allocation across this wide opportunity set allows us to construct a portfolio that maintains the real value of the capital invested, while delivering an attractive and resilient income.

Experience

In managing the strategy, we are able to build on the recognised strengths of Baillie Gifford – in particular, our success and experience in managing multi-asset portfolios investing across all of these asset classes, and investing in other essential components such as global equity income and specialist bond mandates.

Robust Process

To combine and manage these assets in the optimal way a rigorous and repeatable process is necessary. Our Multi Asset Income process is designed to ensure we have well-considered inputs and clarity of roles and responsibilities, in order to generate the right output: a portfolio which delivers the benefits of active management and a clear focus on income

The benefits of Multi Asset Income

Income reliability

First and foremost, Multi Asset Income aims to provide a diversified and resilient stream of income, allowing clients to incorporate the monthly distribution into their overall income requirements. We aim to grow income in order to maintain its real value over the long term, and to minimise the volatility of the distribution over shorter periods.

Reduced sequencing risk

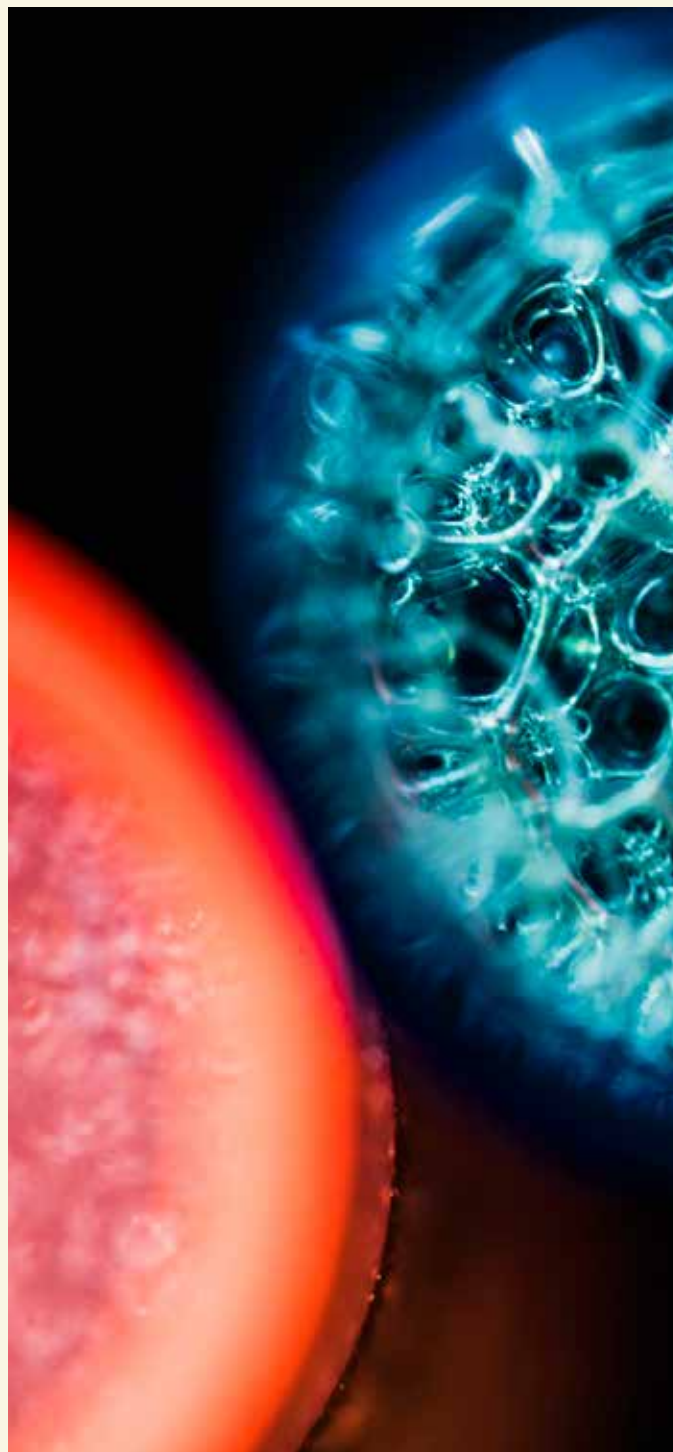
Overall investment returns are adversely affected when drawdowns (the sale of assets to convert capital to income) are made during periods of poor returns. This is called 'sequencing risk' (described further in Appendix 1), and the impact of this risk increases with greater volatility of returns. Multi Asset Income aims to address this in two ways: first, by providing a high level of income to reduce the need to draw on capital; and, second, by investing in a diverse range of assets with distinct characteristics, thereby reducing capital volatility when assets have to be sold.

Sustainability

We aim to deliver the highest level of income we believe is sustainable, while preserving the value of capital in real terms over the long term. This careful balance of current income and long-term sustainability means clients can rely on the strategy to meet their long-term needs. Governance and sustainability considerations are firmly embedded into our investment process to align with this long-term focus.

Clarity of purpose

The clear purpose of Multi Asset Income can help clients to construct an overall investment mix that is appropriate for their individual needs. Combining Multi Asset Income with other investments can provide flexibility in approach if required.



About Baillie Gifford

Baillie Gifford is an independent investment management partnership established over 100 years ago.

The structure of the firm provides stability, helps to retain key personnel, and offers advantages in long-term business management, training, communications and team work. Baillie Gifford is based in Edinburgh, and wholly owned by our current partners who all work within the firm.

We have separate teams that specialise in the main activities of investment, client service, dealing, settlement and compliance. We believe this specialisation enhances our performance in each of these key activities and is an important internal control.

People

Our people are fundamental to our success and the partnership structure allows us to put our clients' needs first, rather than external shareholders.

Baillie Gifford's partnership structure has provided the foundation for an enviable record of corporate stability and firmly aligns us with the long-term interests of our clients. The structure is also a significant factor in our ability to attract and retain the very best investment talent. Our selection policy is based on intelligence, leading to the recruitment of individuals from a wide range of academic disciplines, with usefully different perspectives and approaches to analysis. Most of our analysts and investment managers are trained in-house, our aim being to combine a common culture with an atmosphere that encourages vigorous debate. The firm's values and beliefs are clearly communicated and, coupled with low staff turnover and long service, the firm has been able to capture a strong team spirit while growing steadily in recent years.



Our investment approach

Our competitive advantage lies in understanding what matters and what is simply market noise, and in our ability to wait patiently to take advantage of periodic mispricing – both at asset class and security level. Baillie Gifford's investment decisions are based on thorough research, though we have the capacity to act quickly if necessary.

Location

The location of the majority of our investment staff are in Edinburgh which enables us to share investment views and ideas, and facilitates the efficient implementation of the Multi Asset Income process. The strategy is managed directly by a specialist team of Multi Asset Income investors who draw on the extensive resources of our Fixed Income and Equity teams as well as the expertise we have in managing multi-asset portfolios.

Broad expertise

Baillie Gifford has been successfully running multi-asset portfolios investing in a broad range of asset classes for over ten years, and has a strong reputation in the marketplace. We also have relevant specialist expertise in running global equity income and fixed income strategies, and in the field of governance and sustainability.



The Multi Asset Income investment team

The Multi Asset Income strategy is managed by a highly experienced group of four investors drawn from each of our specialist Equity, Fixed Income and Multi Asset teams. We call this the Portfolio Construction Group (PCG). The members are: James Dow, co-head of our Global Income Growth team; Steven Hay, Head of Income Research; Lesley Dunn, Head of Credit; and Nicoleta Dumitru from our Multi Asset team. The role of chairperson rotates amongst the group in order to keep the debate fresh and avoid behavioural bias.

The PCG works closely with the other investors across our Multi Asset, Global Equity and Fixed Income teams, drawing on their expertise in asset class research, portfolio construction and risk management.

Multi Asset Income Portfolio Construction Group



James Dow

Co-Head of Global Income

Years of experience: 17 (17)



Nicoleta Dumitru

Multi Asset Investment Manager

Years of experience: 8 (8)



Lesley Dunn

Head of Credit

Years of experience: 20 (5)



Steven Hay

Head of Income Research

Years of experience: 27 (17)

Equities

Global Income Growth team of 6

99 other equity investors across the firm

Average investment professional experience **11** years

Multi Asset

Multi Asset team of 8 investors

Average investment professional experience **11** years

Fixed Income

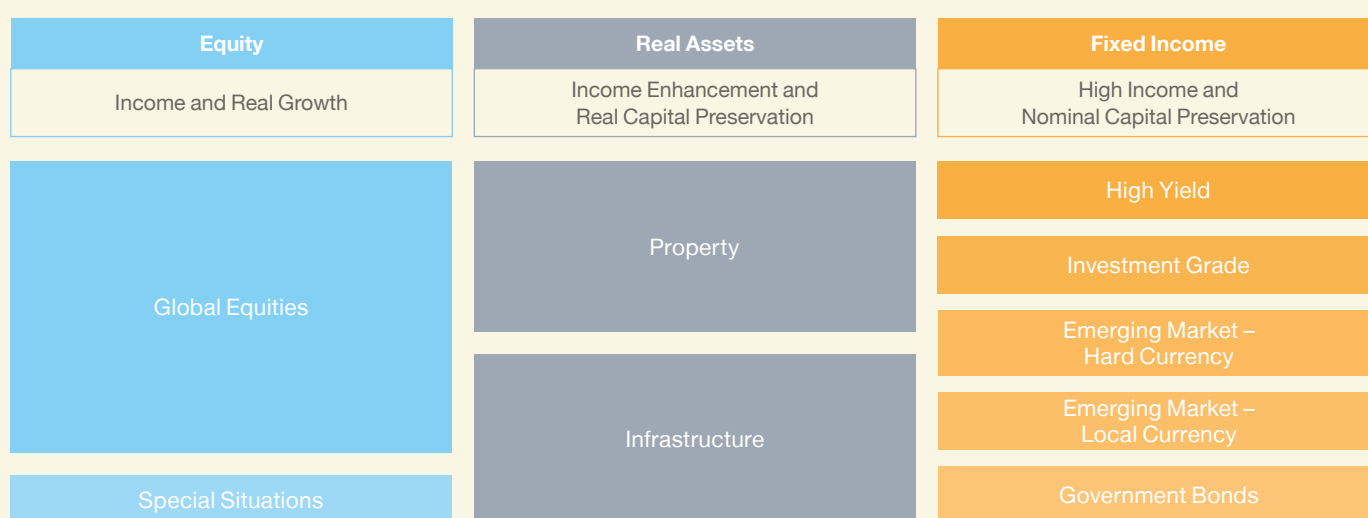
22 investors across five teams

Average investment professional experience **11** years

Range of asset classes

The Multi Asset Income strategy invests across a broad range of asset classes. We believe the most appropriate way to achieve our objective is through active management, utilising a broad opportunity set, with a clear focus on long-term income and capital preservation.

The range of asset classes we typically invest in is shown below:



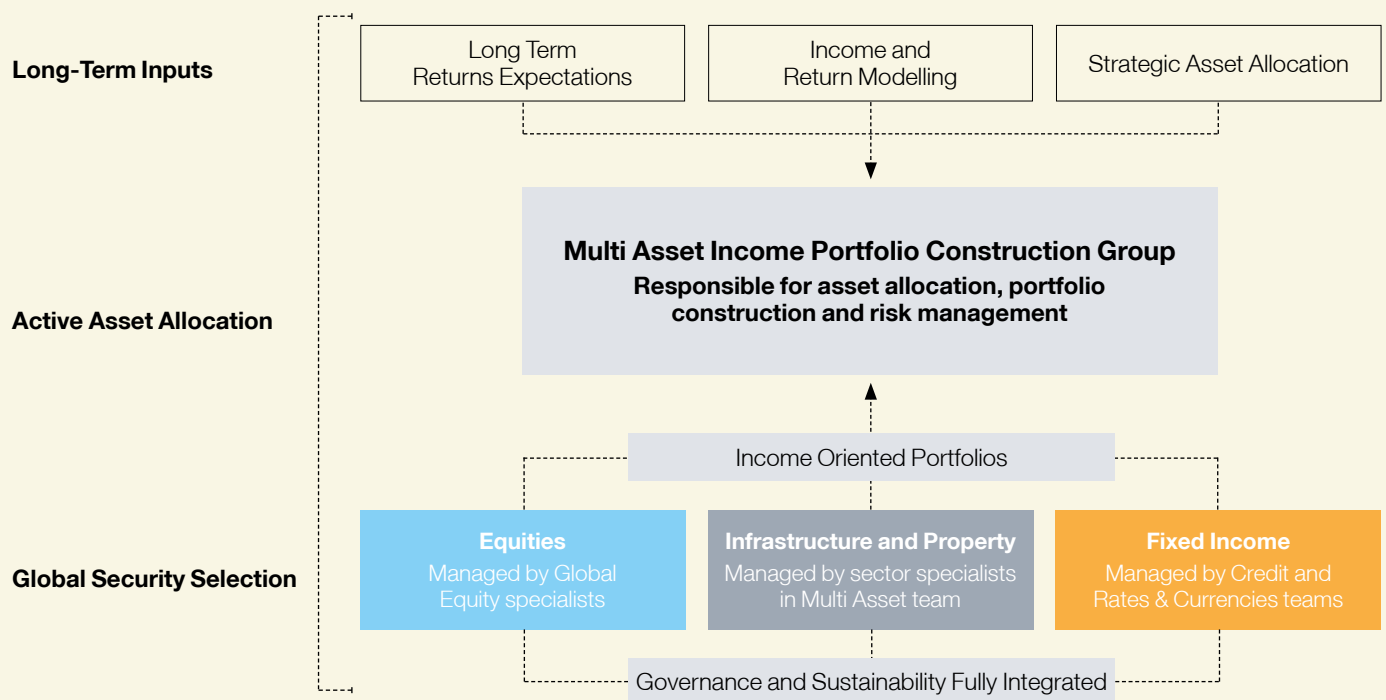
Equities, other real assets and fixed income assets have complementary characteristics, and blending them can produce a portfolio which meets the objectives of the strategy much more effectively than any individual asset class.

- **Equities** provide an essential component in any approach which aims to grow income and capital in line with inflation, because they are the primary route for benefiting from economic growth and corporate success. As part of a strategy that has an income focus it is clear that the level and dependability of dividends is important, and so too is the prospect of dividend growth from the portfolio as a whole. In addition there may be special situations where the emphasis is on diversification relative to the overall portfolio. Overall, it is the real growth from equities which allows the strategy to invest also in other assets that have higher nominal yields but less potential for growth.
- **Property and Infrastructure** are ideal components for a strategy which aims to provide an attractive income stream which maintains its value in real terms, because they benefit from both a high current income, and contractual or economic protection against inflation. In managing these assets as part of the Multi Asset Income strategy, it is important that the focus is on income rather than total returns. Where these assets are held through equity vehicles short-term performance will be influenced by other factors, but over the long term it is the performance of the underlying assets which will underpin both income and overall returns.
- Under the broad heading of **Fixed Income** there are diverse opportunities for owning assets which provide a high current income. We have studied the history of income production across asset classes and noted how different fixed income assets offer excellent diversification benefits which should underpin the resilience of Multi Asset Income's distribution. Along with the ability to actively allocate between the wide range of fixed income assets, there are opportunities to further enhance income whilst protecting capital through careful stock selection, sound macro economic judgement and hedging strategies.

This broad range of asset classes provides clear benefits for the Multi Asset Income strategy. The diverse sources of risk bring associated diversification benefits in the area of income resilience, and help lower the overall volatility of returns. Importantly the broad opportunity set provides wide scope for active asset allocation, ensuring the strategy can take advantage of changes in market conditions.

Investment process

The Multi Asset Income process is designed to ensure that the benefits of active management, a broad opportunity set, and a clear focus on long-term income and capital preservation are fully realised. We draw on specialist research at both the asset class and individual security level, and on our asset allocation and portfolio construction expertise in order to construct a portfolio with a dedicated income focus.



Long-term perspective

A number of important inputs to the investment process help inform our short-term decisions by providing long-term context:

- Each year we produce a set of **long-term returns expectations**, which includes estimates of the prospective returns across the various asset classes they research and invest in. This analysis is built on a number of years of internal research into fundamentals and historic returns, as well as external specialist and academic input.
- We decompose these long-term returns into income and growth components, and use these to carry out **income and return modelling** for the Multi Asset Income portfolio.
- Together these analyses lead us to ascertain the **strategic asset allocation** that should allow us to meet our objectives over the long term. This is not a strategic benchmark – nor is it static – rather it is a range of asset allocations that are consistent with the long-term objectives of the strategy, and help anchor shorter-term portfolio decisions

Income oriented portfolios

Bespoke portfolios in each asset class are constructed specifically to meet the objectives of Multi Asset Income, with stock selection delegated to named fund managers or teams. We believe a focus on income is essential in all aspects of portfolio construction, and we benefit from the depth of resource and expertise across Baillie Gifford in selecting individual securities from a global opportunity set. Getting the stock selection right and favouring resilient companies and countries that will not cut dividends or default on coupons is particularly important in limiting the income drawdown in extreme market conditions.

Active asset allocation, portfolio construction and risk management

The Multi Asset Income PCG has full responsibility for all asset allocation decisions in the portfolio, for delegation where appropriate (to specialist teams as described above, for example), and for determining hedging policy.

The PCG formally reviews the asset allocation every two months but there is continual review of the portfolio and the team can make decisions at any time. The PCG also reviews each asset class on a rolling basis, bringing in specialists from relevant teams where necessary. The close interaction of all our investors at Baillie Gifford enables many further informal discussions to give the PCG a high degree of insight into the many different factors that influence the investment decisions they make.

In making its decisions, the PCG is at all times wholly aware of the specific securities held in the underlying portfolios in each asset class, assisted by the direct role of the PCG members in managing underlying assets in each area. This ensures that any decisions and relative judgements are based on the characteristics of these underlying portfolios, rather than the broader asset class. In allocating assets we focus on current and future income, and on capital preservation.

While the long-term inputs described above help provide perspective, asset allocation decisions are dynamic – we retain broad latitude to ensure this is the primary tool to manage risks. Risk factors are considered on a holistic basis across the whole portfolio.

We also use simple derivatives to hedge certain risks where it is most efficient or appropriate to do so. For example, our policy is to hedge the majority of foreign currency exposure to sterling using currency forwards. We may also use interest rate derivatives to help protect the fixed income proportion of the portfolio against yield increases, or credit default swaps to offset some element of credit risk borne by corporate bonds.

We will not use derivatives strategies designed to enhance income, such as writing call-options.

Spotlight on Security Selection

Equities

Our specialist Global Income Growth team invests in companies which can pay dependable dividends across the cycle, and which also have the prospect of real growth in profits, which will in turn lead to growth in dividends and capital over the long term. We also look for special opportunities which bring diversification to the portfolio. We have 91 investors researching equities within Baillie Gifford, and Multi Asset Income benefits from this breadth and depth of specialist knowledge in uncovering attractive opportunities for the portfolio.

Infrastructure and Property

We typically invest in listed closed-end vehicles, selected by sector research specialists in our Multi Asset team. Naturally these real assets tend to generate attractive levels of income, but we further tailor our selection specifically for the Multi Asset Income portfolio and its objectives. While these listed securities can have equity-like characteristics over short periods, in the long-run they possess more bond-like properties with stable cash-flows, and typically with some element of inflation linkage.

Fixed Income

Our Credit and Rates & Currencies teams focus on selecting individual bonds in focused portfolios, based on in-depth fundamental research. Within high yield, for example, we focus on resilience and diversity – we look for bonds with idiosyncratic risks we believe are well-rewarded through the cycle. Within emerging markets, our fundamental research looks to identify those countries with sustainably high bond yields and those undergoing positive structural changes.

Risk management

Risk management is an essential element of the Multi Asset Income strategy. As income is the primary objective of the strategy, one of the most important ways of ensuring resilience of income is to avoid over-dependence on any one source. Therefore, we pay particular attention to the short-run volatility of income and this takes precedence over short-term volatility of capital.

Maximum one year decline in income

Our focus on limiting the volatility of income is primarily expressed in terms of protecting against a material fall. We manage the strategy with the aim of limiting any forecast decline in income to 10% on an annual basis. We regularly measure forecast income levels, and where the projected values show a decline greater than 10% the PCG will take action to adjust the portfolio in order to increase income. However, if we believe this action would likely result in a permanent loss of capital, reducing our ability to make future income distributions, we would allow income to fall further than 10%.

Diversification guidelines

We manage the strategy with guidelines that limit the proportion of income that can come from any one asset class or security, and ensure the portfolio will always be well-diversified:

- Minimum of five asset classes with at least 5% invested in each of them
- Maximum of 5% forecast income from any one security in a given year
- Maximum 50% forecast income from any one asset class in a given year

Scenario analysis

Scenario analysis forms a major pillar of our risk assessment process for the strategy. This consists of assessing the likely performance of the asset classes in which we invest over the next twelve months across a range of core and specific scenarios, as well as the likely short-term performance of the same asset classes in a range of extreme scenarios.

Risk models

We have a separate independent Investment Risk team, who use risk models to provide a quantitative perspective on the portfolio. This helps inform our understanding of the portfolio and the range of risks it is exposed to. The team monitors realised and expected risk levels within the portfolio on both a daily basis using the APT model, and on a monthly basis using the Moody's Analytics model.

Peer review

Peer review sees the investors and its investment decisions being constructively challenged by senior colleagues from elsewhere in Baillie Gifford. We think this is a valuable part of our process and helps the team avoid behavioural risks such as over confidence, as well as providing useful input to the generation of investment ideas. The main forums for this peer review are regular meetings with the Multi Asset Review Group and the Investment Risk team.

Liquidity

Liquidity is an area of key importance to ensure daily dealing – this is carefully considered and the Multi Asset Income PCG abides by the following rules:

- The portfolio must be sufficiently liquid to meet immediate notice redemptions equivalent to 10% of assets, with a mid-bid spread no greater than 2% (in normal market conditions)
- The portfolio typically invests directly in listed securities, but where external open-ended funds are held, no more than 5% of the portfolio is to be invested in monthly dealt funds; no more than 10% may be invested in weekly and monthly dealt funds combined.

Multi Asset Review Group



Torcail Stewart

Investment Manager

Years of experience:
16 (13)



Matt Brett

Investment Manager

Years of experience:
18 (18)



Spencer Adair

Investment Manager

Years of experience:
21 (21)



James Squires*

Investment Manager

Years of experience:
15 (15)



John Berry

Investment Manager

Years of experience:
12 (12)



Helen Roxburgh

Client Service
Manager

Years of experience:
10 (7)



Tim Alcorn

Head of investment
Risk

Years of experience:
16 (16)

Governance and Sustainability

It is our firm belief that embedding governance and sustainability considerations into our investment process is helpful in achieving our aim of providing good long-term investment performance to our clients. Baillie Gifford has a long history of responsible investing. We have been a signatory of the United Nations Principles for Responsible Investment since 2007, and have always been highly rated. We were awarded the new top A+ rating which was introduced in 2017.

As long-term investors, we believe our investment approach is naturally well-

aligned with governance and sustainability considerations, because we aim to consider all factors that are material and relevant to the return potential and risk profile of each investment. We also prioritise effective dialogue with companies on governance and strategic issues, particularly where this has the potential to enhance returns, reduce risk or improve disclosure and reporting.







We have a dedicated Governance and Sustainability team of 23 which sits centrally on our investment floor, and which is responsible for developing and co-ordinating our ESG-related research in conjunction with

our investment teams. The Multi Asset Income team, and the other specialist teams which support our Multi Asset Income strategy, work in a collaborative manner with the Governance and Sustainability team who contribute and provide guidance on relevant issues.

As well as working with each investment team to provide support in this area, our Governance and Sustainability team also monitors and conducts related research on the individual companies held in Baillie Gifford portfolios, including those in which our Multi Asset Income strategy invests.



Biographies of key personnel

Multi Asset Income investment managers		<p>James Dow</p> <p>James was appointed Co-Head of the Global Income Growth team and Co-Manager of The Scottish American Investment Company PLC (SAINTS) in 2017. He joined Baillie Gifford in 2004 on the Graduate Scheme and became an Investment Manager in our US Equities team. Previously, James spent three years working at The Scotsman newspaper, where he was the Economics Editor. He is a CFA Charterholder, graduated MA (Hons) in Economics-Philosophy from the University of St Andrews in 2000 and MSc in Development Studies from the London School of Economics in 2001.</p>	Clients Department		<p>Paul Roberts</p> <p>Paul is a Director in the Clients Department and a Multi-Asset and Income Product Specialist. He joined Baillie Gifford in 2013 after more than 10 years of experience in the investment industry. Paul graduated MEng in Aeronautical Engineering from the University of Bristol in 1999.</p>
		<p>Steven Hay</p> <p>Steven joined Baillie Gifford in 2004 and is Head of the Income Research team. Prior to joining Baillie Gifford, Steven was a Fixed Income Investment Manager with Scottish Widows. His experience includes seven years undertaking analysis and research for the Bank of England's Monetary Policy Committee, and involvement in managing the UK's foreign exchange reserves. Steven graduated BAcc (Hons) in Economics and Accountancy from the University of Glasgow in 1992 and MSc in Economics from the University of Warwick in 1993.</p>			<p>Lucie Majstrova</p> <p>Lucie is a Multi-Asset and Income Product Specialist in the Clients Department. She joined Baillie Gifford in 2021 after 9 years at HSBC Private Banking where she focused on investment advice for private clients. Lucie has an MA in International Economics from IHEID in Geneva and is a CFA Charterholder.</p>
		<p>Lesley Dunn</p> <p>Lesley is Head of the Credit team and is a CFA Charterholder. Prior to joining Baillie Gifford in 2016, Lesley worked for Scottish Widows Investment Partnership and latterly Aberdeen Asset Management for 15 years, initially in the Investment Grade Team before moving to manage the company's High Yield portfolios. Lesley graduated BSc (Hons) in Maths, Statistics & Economics from the University of Strathclyde in 2000.</p>			
		<p>Nicoleta Dumitru</p> <p>Nicoleta joined Baillie Gifford in 2013 and is an Investment Manager in the Multi Asset Income team. She graduated BSc (Hons) in Management and Marketing from the University of Manchester in 2013.</p>			

Appendix 1 – Reducing sequencing risk with a Multi Asset Income fund

One of the challenges facing investors requiring regular income over a period of time is so-called ‘sequencing risk’, also known as ‘path dependency’. This risk stems from the unknown sequence of periodic investment returns that assets will deliver over time. If an investor relies on capital drawdown – the sale of assets to realise ‘income’ – the overall financial outcome can vary significantly. Financial assets do not generate returns in a linear fashion, and even if the same compound return is achieved in two different scenarios, the particular paths to that return are likely to vary considerably. If a series of poor returns are experienced in the early years, capital drawdown can crystallise losses and lead to significantly worse outcomes in the long term.

The stylised example which follows, considering a typical retiree to illustrate this risk, shows how it can be reduced by investing in a Multi Asset Income strategy.

Suppose Mrs Jones retires at age 60 with assets worth £100,000. Her investment plan is to draw down £4,000 annually to finance her

retirement expenses. At the same time she hopes her assets will achieve a 4% compound return, matching her expenditure, such that in 10 years when she reaches age 70 she will have preserved her £100,000 pot to pay for nursing home and other health expenses.

Path A shown in the table below is a random series of returns, with a magnitude and variation that is not untypical of the experience Mrs Jones may have by investing in the stock-market. If Mrs Jones experiences this path of investment returns, and sells £4,000 of assets each year to provide her income, she will meet her objective: her pot will be £108,000 at age 70.

Path B shows the same series of returns, but in reverse order – therefore both A and B deliver a compound return of 4% per annum over the 10 year period. But B now includes a series of poor investment returns in early years, during which Mrs Jones is consistently selling capital, and this causes her to miss her £100,000 target – she is left with only £88,000. The greater the variance of these returns, the more by which she may miss her objective.

Age	60	61	62	63	64	65	66	67	68	69	70	Compound return, p.a.
Path A – total returns		5%	18%	8%	22%	4%	21%	1%	-23%	-18%	13%	4.0%
Path A – balance of capital with drawdown (£k)	100	101	115	120	143	145	171	169	126	99	108	
Path B – total returns		13%	-18%	-23%	1%	21%	4%	22%	8%	18%	5%	4.0%
Path B – balance of capital with drawdown (£k)	100	109	85	62	58	67	65	76	78	88	88	

Now suppose Mrs Jones is offered a Multi Asset Income fund at retirement. Let us assume for simplicity that its objective is to generate an income return of 4%, or £4,000 based on Mrs Jones’ initial investment, and that the fund aims to preserve income and capital over time.

By focusing on income, the fund should be able to exploit the fact that the income volatility of most financial assets is, by its nature, significantly lower than their capital volatility. By investing across multiple asset classes, the fund should be able to reduce this income volatility further through diversification. Active stock selection should reduce its income volatility further still, so that each year the income distribution remains close to the £4,000 Mrs Jones requires.

Such an approach should protect Mrs Jones from capital volatility, because she will no longer be drawing on her capital to meet expenditure. In the real world it may be that Mrs Jones wishes to spend more than the Multi Asset Income fund’s targeted annual income return. She will then need to draw down capital periodically to finance the difference. But the fund will still meaningfully reduce her sequencing risk, even if it cannot eliminate it entirely, due to lower capital volatility and a smoother path of overall investment returns.

Appendix 2 – The importance of preserving capital in an income strategy

We state, as one of the core beliefs for our Multi Asset Income strategy:

- Capital preservation is what supports future income payments and it must not be sacrificed in an attempt to support an unsustainable level of income.

Ignoring capital preservation has led many income funds into serious difficulties. Below we illustrate why this belief is so important.

Let's say the manager of an income fund receives £100 of capital from clients and s/he invests that capital to generate a 4% yield, i.e. £4 of income. Let's assume that like our own strategy, the primary objective of the manager is to maintain the £4 distribution in real terms. What will happen if s/he does not also preserve the value of the strategy's capital, over the long-term?

The table below shows an example where the value of a fund's capital has declined over time (and assumes for simplicity that inflation is zero, so the income target is maintained at £4 per year). Perhaps some of the bonds the manager purchased have defaulted, and the recoveries have been a fraction of the capital invested. Perhaps some of the property investments were unable to refinance during a period of market stress, and were wound up at fire-sale prices.

Whatever the causes were, if the portfolio's capital value falls

permanently (and we are talking about permanent losses of capital here, not temporary fluctuations as valuation multiples expand and compress) then for the manager to maintain the initial £4 of income, the yield on the portfolio must rise. In the table below, the capital value has declined to £79 after ten years. This is a seemingly modest decline of only 2.3% per annum but it has compounded to a 21% loss of capital over time. To maintain the income at £4, the manager now needs to invest in assets with an average yield of 5.1%.

This will force the manager to take on higher yielding assets, to replace the distressed assets where income has been lost. In doing this the manager is likely to be taking on ever-greater risk. This can easily spiral out of control, if the higher risk assets experience further losses of capital, requiring higher yielding assets to take their place, and so on.

Part of the mind-set that is necessary for running a successful income fund over the long-term is to recognise the importance of capital preservation. Targeting capital preservation does not mean the manager should invest only in the likes of highly-rated low-risk bonds, for example. Some risk must still be taken in pursuit of an attractive yield, and there must of course be tolerance for temporary drops in capital values, for example when valuations fall as market sentiment turns down periodically. But over the long term, capital preservation is a vital component of maintaining the income level paid to clients.

	Launch	End Year 1	2	3	4	5	6	7	8	9	10
Real Capital	100	98	95	93	91	89	87	85	83	81	79
Real Income Targeted	4	4	4	4	4	4	4	4	4	4	4
Real Yield Required	4.0%	4.1%	4.2%	4.3%	4.4%	4.5%	4.6%	4.7%	4.8%	4.9%	5.1%

