

# OUR TWO CENTS

June 2024



**NEW ROAD CAPITAL**  
INVESTMENT MANAGEMENT

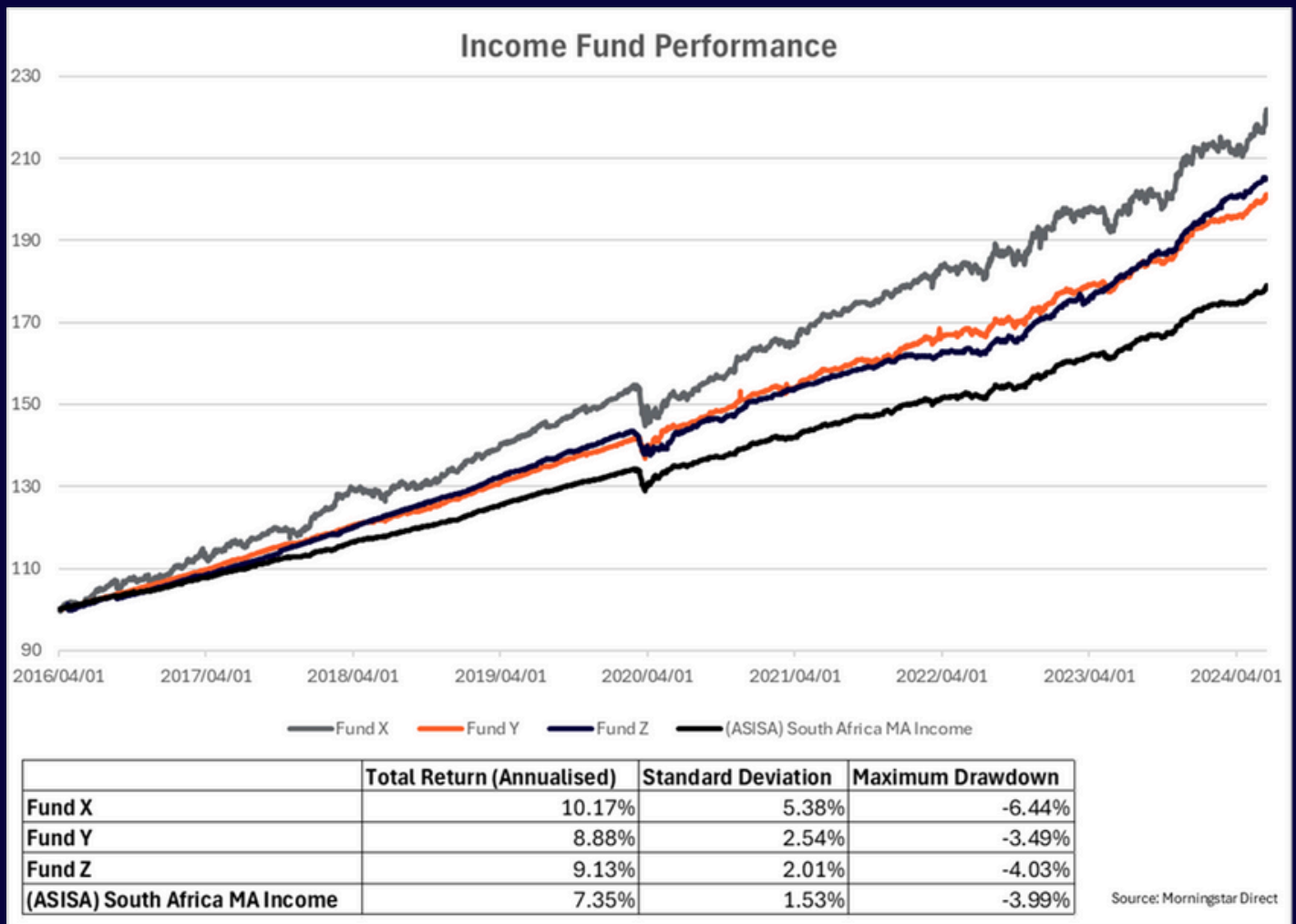
## Income Funds: Differences and Benefits

It isn't uncommon to place a lot of emphasis on the equity portion of a portfolio and overlook the value that various income funds can bring to a multi asset portfolio. The income space offers a much wider variety of strategies relative to equity funds and, thus, more risk factors that one can choose to take exposure to.

For example, some funds focus exclusively on listed corporate credit and providing investors with as broad a portfolio as possible, thus minimizing the impact of individual defaults and allowing investors to collect a general credit spread. Other funds, choose to focus on mispricing of highly liquid debt instruments, such as government debt, to create value. A third strategy is to simply build a well-diversified income generating portfolio using a variety of different income instruments that offer the best value relative to their risk. Each of these funds will have a different return profile, which is illustrated below.

It isn't uncommon to place a lot of emphasis on the equity portion of a portfolio and overlook the value that various income funds can bring to a multi asset portfolio. The income space offers a much wider variety of strategies relative to equity funds and, thus, more risk factors that one can choose to take exposure to.

For example, some funds focus exclusively on listed corporate credit and providing investors with as broad a portfolio as possible, thus minimizing the impact of individual defaults and allowing investors to collect a general credit spread. Other funds, choose to focus on mispricing of highly liquid debt instruments, such as government debt, to create value. A third strategy is to simply build a well-diversified income generating portfolio using a variety of different income instruments that offer the best value relative to their risk. Each of these funds will have a different return profile, which is illustrated below.



Fund X, a fund that trades instruments in the ALBI, does very well at generating returns higher than the other two and offers a risk managed exposure to the ALBI, however, it still comes with elevated volatility relative to the other two funds. Fund Y, a diversified income fund, has a low maximum drawdown risk relative to Fund X and Z and a more stable income base but lower return and, although the volatility is lower than Fund X, it's higher than Fund Z. Finally, Fund Z generates strong returns with low volatility, but this comes with liquidity risk since this fund contains a diversified portfolio of corporate credit. This risk can be seen materializing in the maximum drawdown, which is higher than Fund Y. These funds are all classified as ASISA South Africa MA Income funds but clearly have very different strategies and risks.

Investors should keep this in mind when building their portfolio as an effective income blend can provide the best return while providing diversification from local and global equity volatility. Income is a key building block in any multi asset fund and, as such, should be constructed with just as much care and attention as the other asset classes. This is particularly true for an investor who wishes to unlock all the benefits that this asset class has to offer while managing the risks specific to this asset class.



**Michael Caroline**  
**Investment Analyst**

BCom (Hons) Investment Management (UP)  
| MPhil in Finance (UP) | Passed CFA Level 3

Michael joined as an investment analyst and has an MPhil (Financial Management Sciences) cum laude specialising in economic psychology and has passed the CFA level 3 exam. Prior to starting at New Road Capital, he worked as assistant lecturer at the University of Pretoria assisting with quantitative investment analysis. He has built and traded on models using CFDs. Outside of work, he enjoys flying motor gliders from Springs airfield as well as sailing his Laser class sailboat.

