Aegon Asset Management

Multi-Asset
10 November 2023

AEGON **INSIGHTS**

How asset allocation decisions evolve to reflect higher yields

The Aegon Diversified Monthly Income Fund has always evolved to meet the challenges and opportunities of the economic cycle. The availability of income today allows for asset allocation decisions that would have been unthinkable when rates were close to zero.

Evolving environment

Markets have been dominated in the last two years by the twin spectres of inflation (which peaked at 40-year highs) and rising interest rates (the 2-year move in UK base rates from just 0.1% to 5.25% today is the sharpest increase since the late '80s). There have been widespread implications across asset classes but the dramatic re-set in bond prices is perhaps the most significant.

In our article, 'The enduring case for multi asset income' of 6 September 2023, we reflected on the significant allocation shifts which the fund's active and unconstrained nature had permitted as those circumstances evolved. It is now time to elaborate on the phrase we used, that "the changing income environment allows for greater exposure to lower-yielding assets within the portfolio".

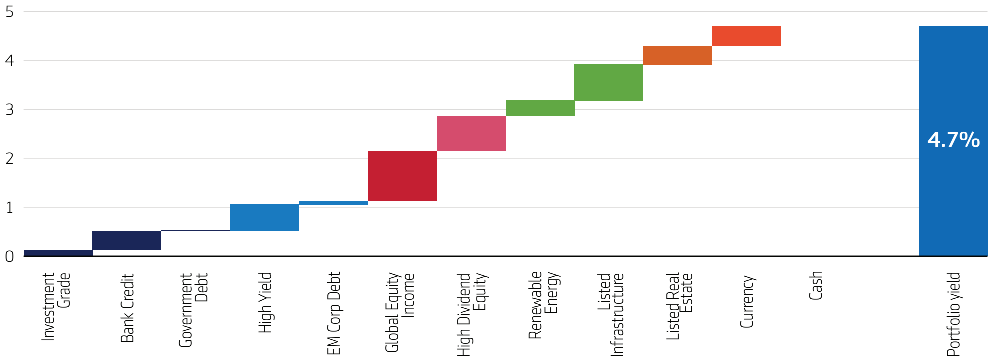
Income investors have had to work hard to capture an attractive level of income ever since the financial crisis of 2008/09. This was exacerbated by the final reduction in rates as Central Banks loosened policy further in response to the Coronavirus pandemic.

Evolving yields

By 30 September 2021, with interest rates still unchanged from their post-pandemic floor, global bond yields were low and credit spreads were at 14 year tights; indeed some $13.1trillion of global debt had a negative yield. Accordingly, the portfolio's allocation to bonds (just c34% of NAV) and their contribution to its income generation were historically low. Figure 1 shows the 12-month forward yield which we forecast* from the fund's portfolio at that date.

Figure 1: Projected 12 month portfolio yield as at 30 September 2021

Contribution to projected portfolio yield (%)



As at 30 September 2021. Fund shown: Aegon Diversified Monthly Income Fund.

*Projected yield is forecast by combining the contractual income our bond holdings will accrue over the following twelve months and the expected distributions of our equity instruments as measured by consensus market forecasts.

Vincent McEntegart
Co-manager, Aegon Diversified Monthly Income Fund

Vincent McEntegart, investment manager, is a member of the multi-asset group. He is co-manager of the Diversified Income strategies. Prior to joining Aegon AM, Vincent worked for Goodhart Partners (an MBO of the multi-manager business of WestLB Mellon Asset Management) where he was a partner responsible for client relationships and new business. Prior to this, Vincent was co-head of investment manager research at Hymans Robertson and a senior member of the investment consulting practice. Vincent has also worked for Alexander Clay Consulting (now part of Aon) and Clerical Medical Investment Group. He has been in the industry since 1987 and started with the firm in 2013. Vincent has a BSc in Mathematical Sciences from the University of Strathclyde and a Diploma in Actuarial Techniques from the Institute of Actuaries.

The combined forecast yield from that third of the portfolio was just 1.12%. Whilst this was clearly not helpful in the context of a 5% objective it was the right call and bonds did, of course, retain some merit for their relatively low volatility and diversification. It did, however, mean other allocations had to pick up the income strain: the two equity sleeves offered a combined 1.74% of prospective yield from c34% of the portfolio; the alternatives allocation (a near record high c31% of NAV in infrastructure, renewable energy asset and REITs) offered 1.4%.

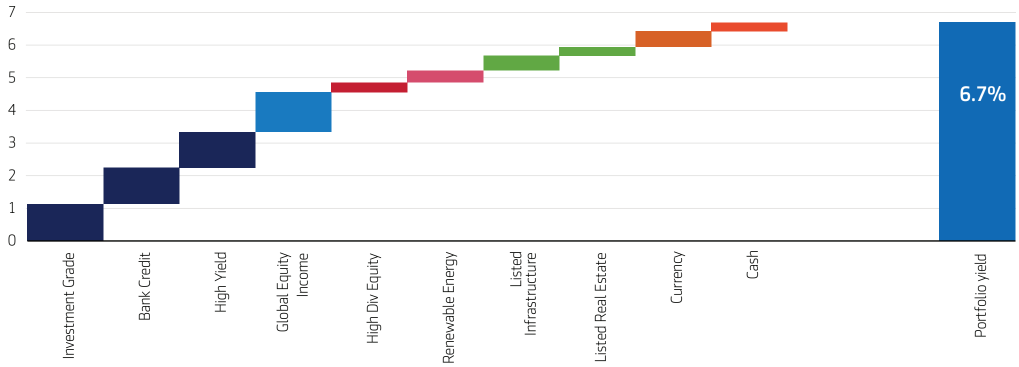
Behind the asset class shifts there were other themes at play, for instance a bias away from US equities since that market is traditionally low yielding towards UK, European and Far Eastern markets where distributions are higher. Nonetheless the combined projected yield was still marginally less than our 5% objective.

Move forward two years and the picture is materially different. Bonds offer half of the fund's significantly better projected yield with the biggest change in the Investment Grade sleeve whose allocation has grown from c5% to c17% of NAV; its 12bp projected contribution has grown to 112bp. Even cash now has something to offer.

> *Bond yields at levels rarely seen since the financial crisis are clearly good news for the ready availability of income.*

Figure 2: Projected 12 month portfolio yield as at 30 September 2023

Contribution to projected portfolio yield (%)



As at 30 September 2023. Fund shown: Aegon Diversified Monthly Income Fund.

Evolving portfolio

Bond yields at levels rarely seen since the financial crisis are clearly good news for the ready availability of income. But there is more to it in a multi asset context.

- **Dampening volatility** – adding to bond allocations, particularly in IG as we have done, allows for lower volatility within the portfolio. When uncertainty remains significant and asset class correlations high, it is surely better to tilt towards the contractual income of bonds and their pull-to-par nature which aids total return.
- **Accessing growth** – being less reliant on equities for income offers a chance to reshape that component of the portfolio by geography, industry and theme. Low average yield from the US equity market is no longer the issue it was. Instead, its growth potential is something than can more readily be tapped.

Similarly, growth themes in other markets are not off limits.

Some 7.4% of the portfolio (25% of our equities) is now invested (end-September 2023) in eight businesses benefitting from the technology & AI theme which has been an important growth engine whilst other parts of the market have faltered. It would have been difficult to own companies like Microsoft (developing AI and holding a 49% stake in ChatGPT) and Broadcom (a global leader in semiconductors and infrastructure software) when income was scarce since they yield less than 1% and 2% respectively. Outside the US there are market-leading opportunities in related industries including integrated circuits (eg TSMC), power for data centres (eg Schneider Electric) and material supplies (eg Shin Etsu Chemical) whose place in the portfolio is more assured when bonds shoulder the income burden.

Sector-wide valuations are always in mind and the current macro uncertainty still reinforces a bias towards quality but the opportunities represented here will, we believe, prove to be significant and enduring. They will change the way the world operates, and it is right to look to be invested.

Always evolving

Markets wax and wane with the economic cycle. Navigating that in real time is a key attribute of Aegon's Diversified Monthly Income Fund, an actively-managed multi-asset fund with a bespoke portfolio that is unconstrained by benchmark.

The outlook is uncertain but the bond re-set of the last eighteen months has thrown up some tremendous opportunities to rethink how we deliver strong risk-adjusted total return - a very attractive income with new opportunities for growth.

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Fund Charges are taken from capital, increasing distributions but constraining capital growth.

^Income is not guaranteed and 5% is a target yield, being the fund's target total distribution over the next 12 months as a percentage of the current mid-market share price. The target yield may be revised in future.

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