Whitepaper | September 2023

Growth, diversification and resilience

Introducing the Aviva Investors Global Equity Income strategy

Global Equity Income Investment Team

It takes Aviva Investors

AVIVA INVESTORS

Contents

Key takeaways

Dividend pay-outs are not only less volatile than equity earnings, but their long-term growth can act as an inflation hedge. Dividends also provide diversification, given a wider spectrum of companies – outside of traditional income sectors – pay and grow dividends these days.

Income strategies can offer greater levels of capital protection in periods of market stress. An allocation to a global equity income strategy can provide clients with a more resilient capital and income profile while serving as a key holding within a diversified portfolio.

Our strategy offers a differentiated approach to sourcing income. Unlike many peers, we look outside of traditional income-paying sectors, as well as seek opportunities from across the spectrum of value and growth, for companies that can combine strong dividends and protection against downside risk with capital growth.

Introduction

The days of easy investment returns are over. While economic growth has held up better than expected in recent quarters, inflation remains elevated and is only receding slowly. As such, the central bank interest-rate tightening cycle continues. Even when rates eventually "normalise", they are likely to be at much higher levels than investors have become accustomed to.

Given this context, we believe an allocation to a global equity income strategy can provide clients with a more resilient capital and income profile, serving as a key holding within a diversified portfolio.

In this paper, we will explore some of the key advantages to global income strategies, dispel common myths and set out our approach.

Dispelling myths

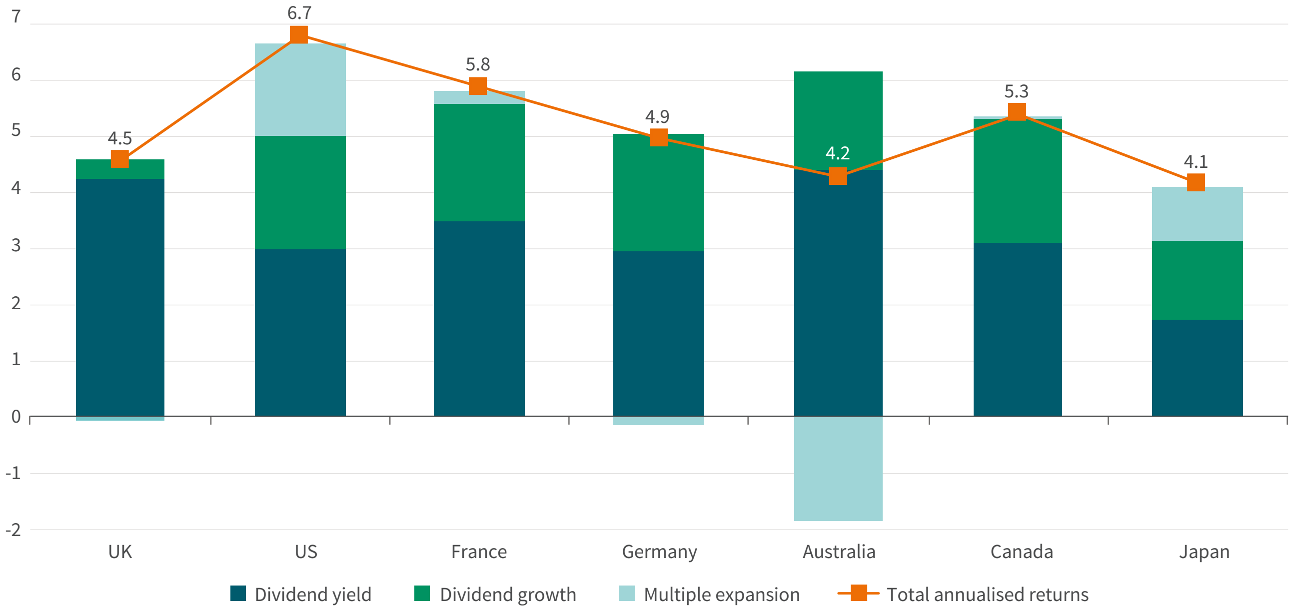
Equities have always been classified as a growth asset class, but the low yields available across traditional income assets in recent years increasingly moved investors to consider their income characteristics, too. However, there are three common misconceptions about equity income investing, namely:

- Such strategies are only suitable for income-seeking portfolios.
- There is little growth potential in dividend-paying companies.
- Dividend pay-outs are unreliable, and success is down to chasing the highest yields.

Dividends have always been an important part of equity total returns (see Figure 1). While the impact over the short term can vary, studies show over longer time horizons there is a significant benefit from the compounding effect of reinvesting dividends. Through the power of compounding, an equity income strategy can deliver attractive long-term capital growth.

> Over longer time horizons there is a significant benefit from the compounding effect of reinvesting dividends

Figure 1. **Breakdown of equity real total returns over the past 30 years (per cent, annualised)**



Past performance is not a reliable guide to future performance

Note: Rolling ten-year annualised real returns since June 30, 1992.

Source: Aviva Investors, Société Générale Research, Thomson Reuters Datastream. Data as of June 30, 2023.

Potential advantages of equity income strategies

Capital protection

Income strategies can offer greater levels of capital protection in periods of market stress. Income-paying stocks tend to be established businesses generating positive cashflows, which should be better able to withstand market cycles than growth-oriented companies that tend to have more volatile stock prices and earnings.

Inflation protection

Higher-yielding companies are typically well-established franchises with the ability to support a sustainable and growing dividend. These dividends, re-invested over time in a well-balanced, high-conviction portfolio, can deliver a powerful compounding total return for investors and a hedge against inflation.

Diversification

Domestic investors have traditionally stayed closer to home on their hunt for income, but the outbreak of COVID-19 in 2020 saw dividends of large UK banks and commodity companies among the worst affected. By comparison, dividends in other regions, such as the US, were more stable. A global approach has the benefit of being able to tap into opportunities in a range of countries and sectors.

Dividends are less volatile than earnings

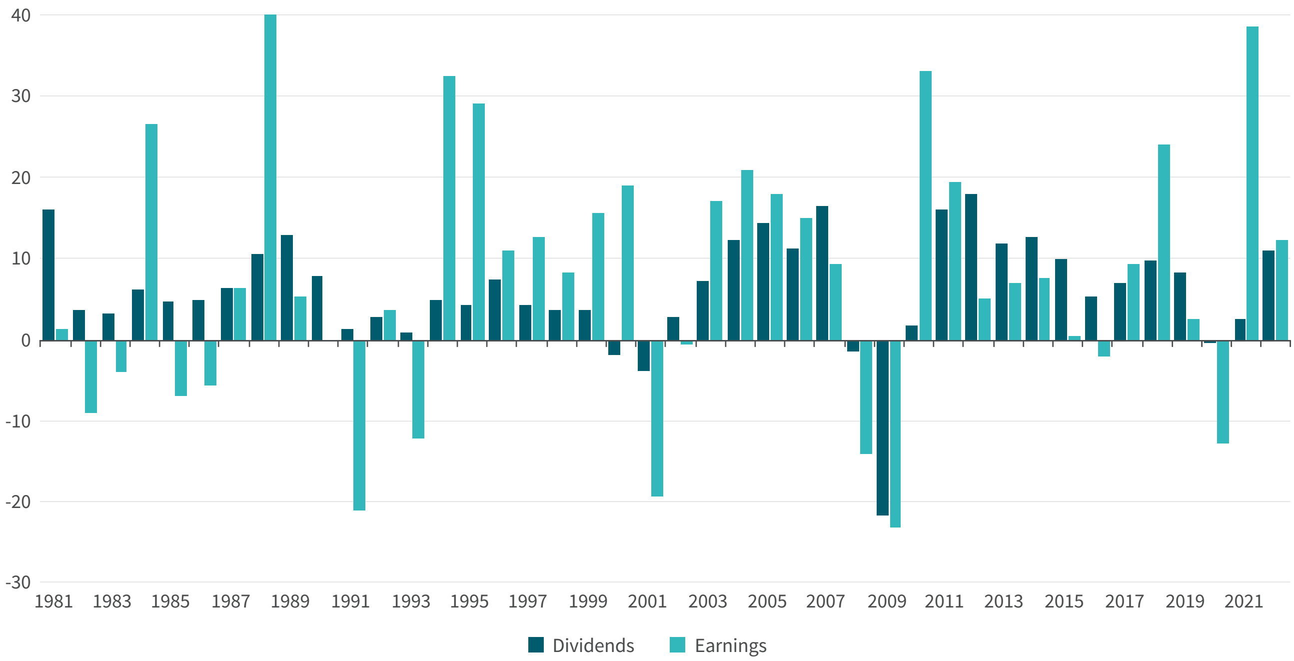
Dividends are paid out of cashflows, not earnings. This important distinction means they are not subject to the various techniques companies often undertake when presenting their earnings (such as adjusted EBITDA, GAAP versus non-GAAP earnings).[1,2]

Paying a dividend is an important commitment to company shareholders. Once undertaken, there is an expectation this income stream will continue and grow over time. While dividends are only part of a company's capital allocation toolkit (alongside reinvesting in the business, share buybacks and acquisitions), we believe they encourage good practices.

Paying a dividend is an important commitment to company shareholders

Historically, during periods where earnings have come under pressure, dividends have as well, but not to the same extent (see Figure 2). That gives us comfort income levels will be sustained, especially from companies in resilient sectors such as healthcare, consumer staples, telecoms and utilities.

Figure 2. **S&P 500 dividends versus earnings per share, year-on-year growth (per cent)**



Source: Aviva Investors, Bloomberg. Data as of December 31, 2022.

In difficult times, a company may choose to reduce or stop its dividend payments to preserve cash and protect its balance sheet. However, the sustainability of dividends is a sign of a company's credibility. When companies have consistently grown their dividends over multiple economic cycles, this can be a useful indicator they have the right characteristics to grow cashflows sustainably in the future.

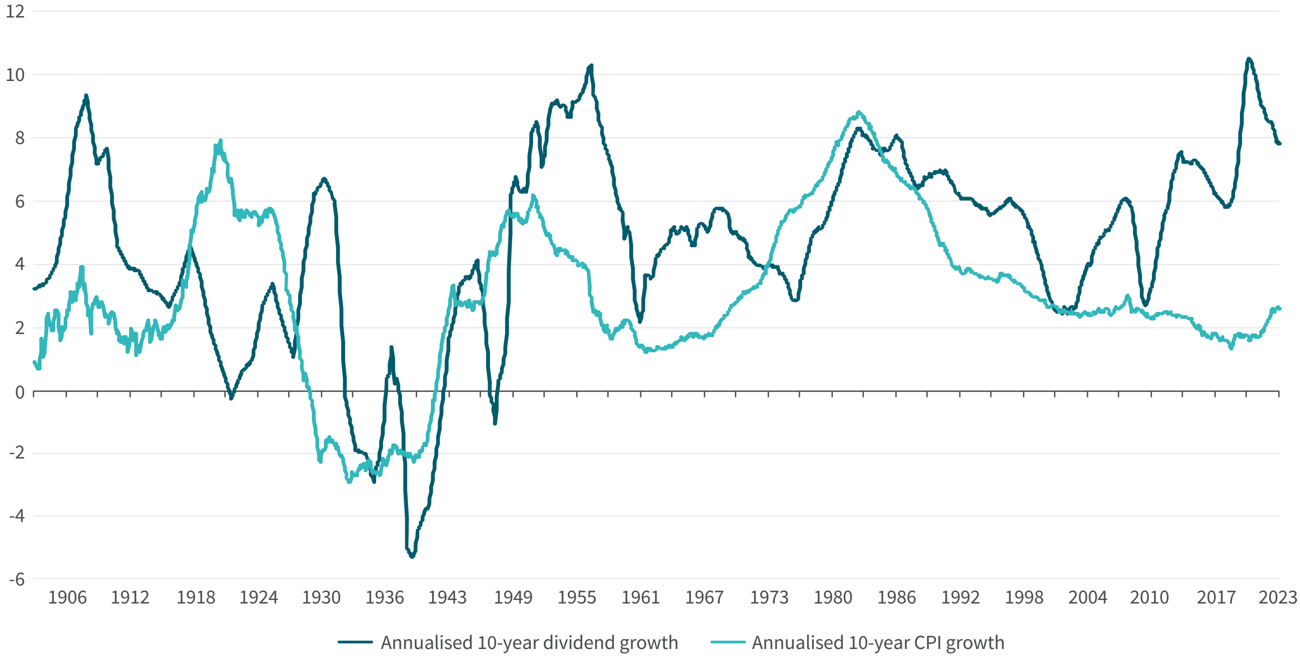
Dividends can offer inflation protection

Dividends can, and often do, rise when inflation does, unlike many bonds and other investments that pay a predetermined rate of interest. Long-term dividend growth provides the hedge for inflation; this, when combined with a company's other characteristics, such as pricing power, can offer protection.

Figure 3, which shows dividend growth of the S&P 500 compared to changes in the consumer price index (CPI), illustrates how dividends have historically offered a hedge against inflation.

Long-term dividend growth provides a hedge for inflation

Figure 3. **Dividends can help offset inflation (1902-2023, per cent)**



Past performance is not a reliable guide to future performance.
For illustrative purposes only, not intended to be an investment recommendation.
Note: Stock market data used in *"Irrational exuberance"*, Princeton University Press, 2000, 2005, 2015, updated.
Source: Robert J. Shiller, Aviva Investors. Data as of March 31, 2023.[3]

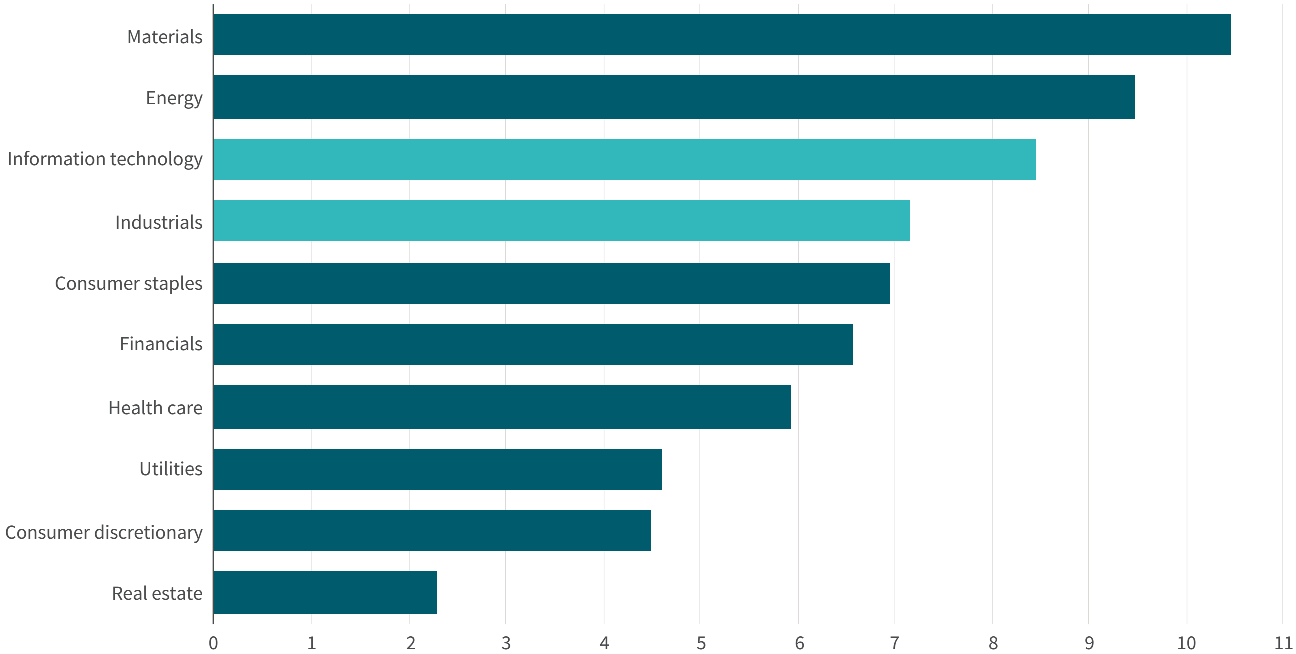
Dividends can provide diversification

The nature of income investing is changing. A decade ago, the opportunity set for income funds was largely limited to companies in traditional income-paying sectors such as financials, healthcare, consumer staples, energy, utilities and telecoms.

Today, income investors can find companies that pay and grow dividends across a wider spectrum, including non-traditional sectors such as technology and industrials (see Figure 4). For example, we have seen a significant increase over the last 20 years in the percentage of US tech companies paying a dividend, increasing from around 20 per cent in 2003 to over 50 per cent now.

Income investors can find companies that pay and grow dividends across a wider spectrum

Figure 4. **Dividend growth over the five years to June 30, 2023 (per cent)**



Past performance is not a reliable guide to future performance

Note: Levels of income growth across sectors for the strategy. Based on MSCI All Country World Gross TR Index using 5-year dividend growth.
Source: Aviva Investors, Aladdin, Explore - Blackrock Solutions. Data as of June 30, 2023.

This provides greater scope to identify companies that look well positioned to benefit from secular growth trends, such as the electrification of vehicles, cloud computing or renewable energy. Through a robust research process, there are more opportunities to find companies combining strong dividends and protection, the traditional cornerstone of income investing, with capital growth.

Introducing the Aviva Investors Global Equity Income strategy

A different approach to investing for income and sustained growth

Our Global Equity Income strategy looks to deliver income and capital growth while aiming for at least 125 per cent of the income return of the MSCI All Country World Index (MSCI ACWI) over any 12-month period. We seek to invest in companies that pay sustainable and growing dividends, backed by strong cashflows and balance sheets.

We use an active, high-conviction approach, focusing on ideas we believe can deliver resilient, long-term returns. We are supported by well-integrated global equity research and ESG teams in seeking the right opportunities.[4]

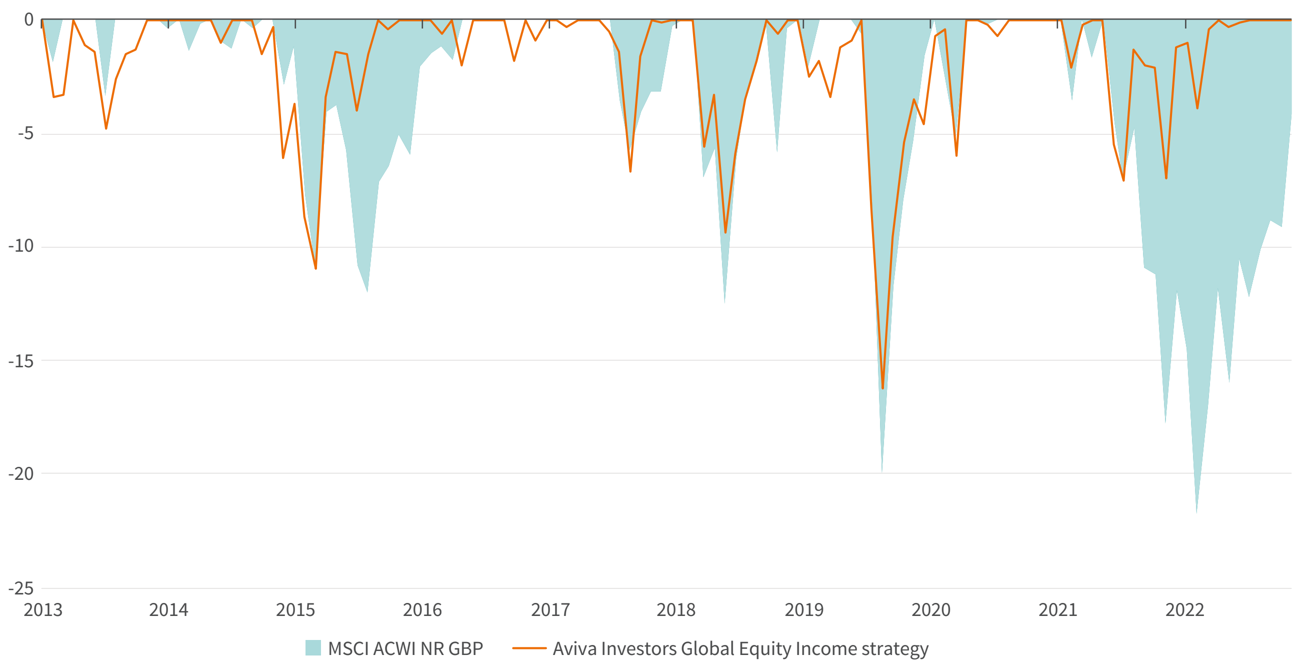
> We look outside of traditional sectors to find ideas in more growth-oriented sectors

While the strategy may appeal to investors seeking a regular income, our focus on growing total returns with an element of capital protection may appeal to those looking for a core standalone holding. In addition, as we seek the best ideas in traditional and non-traditional income sectors, our strategy can serve as a complement to an existing global equity holding or more growth-focused portfolio.

Although the global nature of the strategy provides a diverse universe to source opportunities, our strategy differs in where we look to source that income. Unlike many peers, we look outside of traditional sectors such as consumer staples and banks to find ideas in more growth-oriented sectors such as technology and industrials.

The strategy also seeks opportunities from across the spectrum of value and growth sectors, looking for the right blend where we can not only deliver income and growth but also protection through minimising downside risks. Our strategy has experienced lower drawdowns than the benchmark over the last ten years (see Figure 5).

Figure 5. **A portfolio of resilient businesses with lower drawdowns (per cent)**

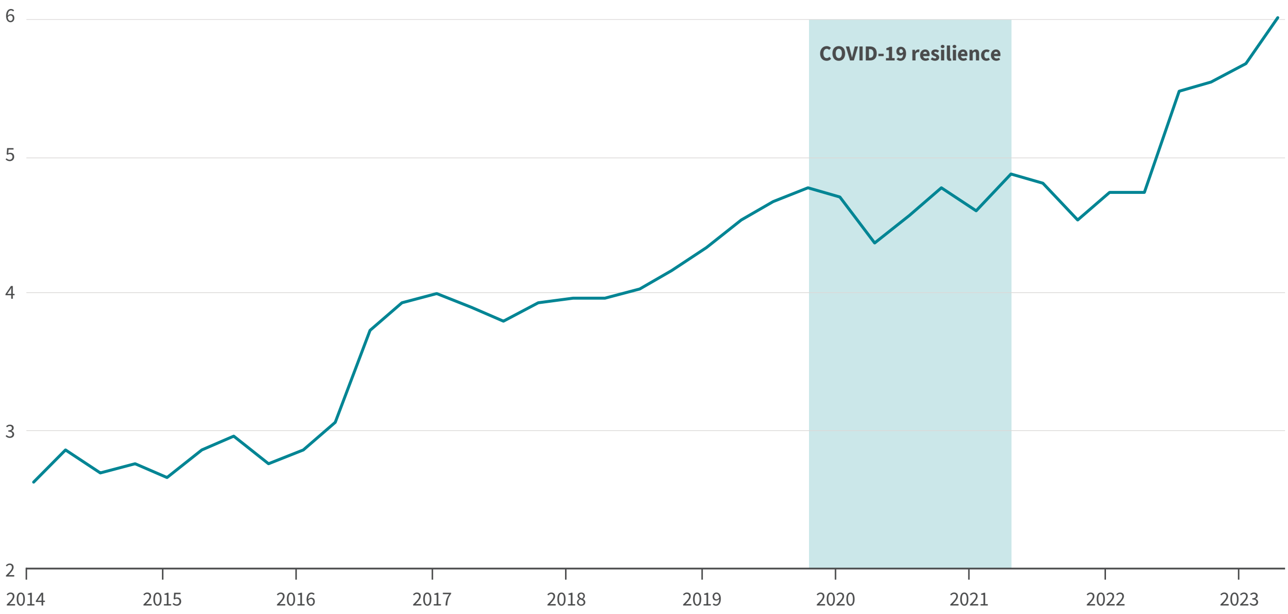


Past performance is not a reliable guide to future performance
Note: A representative portfolio is used to present the strategy.
Source: Aviva Investors, Morningstar. Data as of June 30, 2023.

The strategy is based on a concentrated portfolio of 30-50 companies that have consistently delivered reliable and growing dividends, which we believe is sustainable over the long term (see Figure 6).

While we focus on delivering a sufficient income yield for investors, our emphasis is on ensuring dividends are underpinned by sustainable cashflows, not on chasing high-yielding companies. Given we have access to a wide investment universe, the overlap of our holdings with peers tends to be relatively low, making our strategy complementary to others.

Figure 6. **Resilient and growing income stream, 2014-2023 (annual rolling dividend, pence)**



Past performance is not a reliable indicator of future results

Note: Rolling annual dividend based on quarterly pay-outs. A representative portfolio is used to present the strategy.

Source: Aviva Investors, Bloomberg. Data as of June 30, 2023.

ESG factors also play a vital role in our fundamental analysis of companies. Where we look for durable dividends, we also look for companies that are responsibly managed, which we believe can help sustain their long-term competitive advantage. Drawing on the expertise of our ESG corporate research team, we can identify areas of opportunity, but also ESG risks that could impact our investments. However, ESG is considered alongside other risk factors and the investment manager retains discretion.**

**ESG is considered alongside other risk factors, this is not binding on the investment process and the investment manager retains discretion (beyond the baseline exclusions policy and any specific fund parameters)."

Distinctive elements

When it comes to building a diversified portfolio, we focus on three main characteristics:

1 — Mature yield

Well-established businesses with defensive characteristics, often with an element that is critical from a societal standpoint (e.g., pharma manufacturers, telecoms providers or utilities).

2 — Core yield

Companies with a high degree of predictability in their underlying cashflows, often from a high level of recurring revenues (e.g., health insurers, stock exchanges, elevator manufacturers).

3 — Income growth

Companies in industries with strong secular growth drivers, often resulting in high cashflow growth, which underpins income growth (e.g., cloud computing, digital payments, semiconductors).

By seeking the right balance across these three elements, we aim to construct a portfolio that not only offers capital protection in falling markets but is also able to offer attractive income and capital growth over the long term. Our strategy's distinctive characteristics are summarised in Figure 7.

Figure 7. **Building portfolios with capital protection and growth in mind**

Protection

Through rigorous analysis of company business models, we can find businesses that offer downside protection in periods of volatility. By focusing on these defensive characteristics while ensuring we avoid companies with excessive leverage, we have demonstrated that we can offer a degree of protection in periods of falling equity markets, such as in 2022.

Mature yield

- ✓ Mature businesses
- ✓ Typical yield: >4 per cent
- ✓ Typical dividend growth: <5 per cent

Predictability

We focus on companies that offer predictable free cashflows, avoiding more cyclical companies in favour of those we believe can continue to deliver resilient income throughout market cycles. We look for companies with a strong track record of dividend growth, which we see as a good indicator of future dividend growth.

Core yield

- ✓ Cash compounders
- ✓ Typical yield: 2-4 per cent
- ✓ Typical dividend growth: 5-15 per cent

Upside potential

One of the challenges with income investing is that many strategies have struggled to keep pace with markets in recent years given the strong outperformance of growth over value companies. Our focus outside of traditional income sectors has enabled the strategy to keep pace with markets.

Income growth

- ✓ High cash generation
- ✓ Typical yield: <2 per cent
- ✓ Typical dividend growth: >15 per cent

Source: Aviva Investors. Data as of June 30, 2023.

Figure 8 shows some of the secular growth themes in our portfolio. These include long-term structural themes such as investment in cloud computing and network infrastructure, as well as themes such as renewables and energy efficiency. Our focus is on opportunities where company business models show evidence of recurring revenues and resilient growth, which should lead to sustained income and capital growth.

Figure 8. **Selected portfolio themes and opportunities**

Innovation in global healthcare	**Global communication networks**	**Software and databases for professional services**	**Energy efficiency and grid infrastructure**	**Cloud-based networks, data centres and generative AI**	**Savings and retirement investment**	**Demand for renewables**

Source: Aviva Investors, August 2023.

Take **energy efficiency and grid infrastructure**. There is substantial need for investment in ageing grid infrastructure to facilitate the growing share of renewables as well as manage supply and demand imbalances. Companies that can help with providing electrical products for transmission and distribution (which also help ensure networks are more resilient to weather related events), as well as digitalisation of existing grids, will be pivotal to this transformation.

> Companies that invest in ageing grid infrastructure will be pivotal to the energy transition

Cloud-based networks, data centres and generative artificial intelligence (AI) is another theme where we see opportunities. A growing number of businesses are moving to cloud storage given increasing data requirements, which should benefit companies offering cloud or hybrid storage services. With the more recent focus and investment in generative AI tools, semiconductor companies that manufacture high-performance computing chips with the processing power to support this are also likely to be long-term beneficiaries.

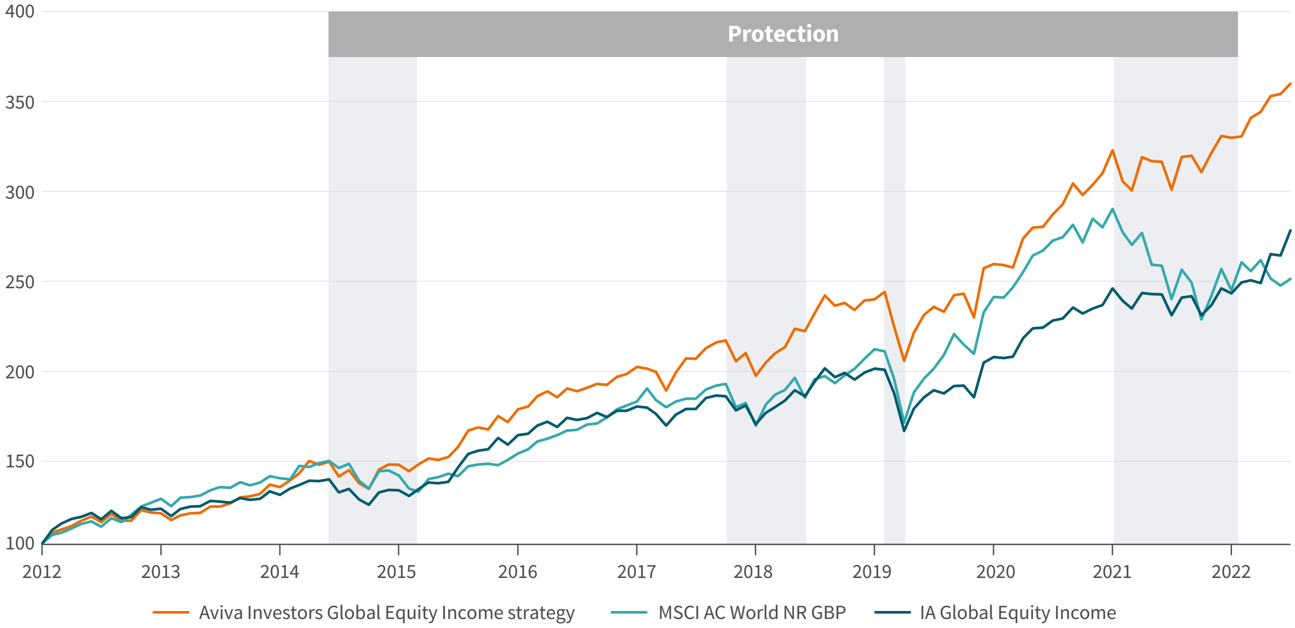
Track record

Investors generally look to global equity income strategies for their ability to provide downside protection. While our strategy has historically delivered on this, we believe it is also well-placed to capture upside, having a higher upside capture ratio versus peers.[5] In our view, this translates into higher dividend growth for our clients.

The historical performance of our strategy is shown in Figures 9 and 10. While the peer group has lagged the MSCI ACWI over the last decade, the Aviva Investors Global Equity Income strategy has kept pace and even outperformed (see Figure 9), delivering top-decile performance over three, five and ten years (see Figure 10).

Figure 9. Track record of providing downside protection and growth

Our strategy has kept pace with the MSCI ACWI during growth stock rallies while peers lagged

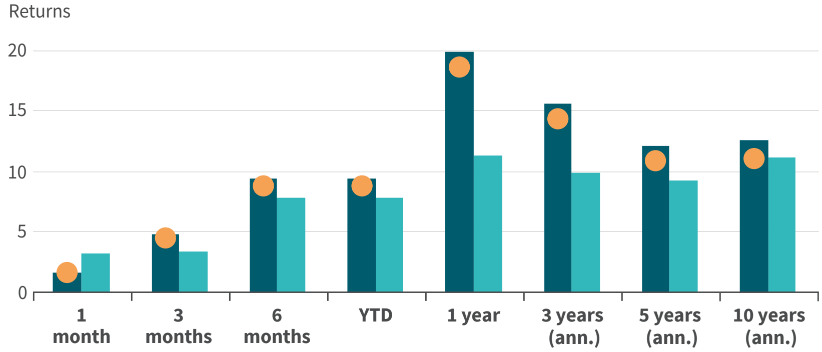


Past performance is not a reliable guide to future performance

Note: Performance is shown gross in GBP. A representative portfolio is used to present the strategy.

Source: Aviva Investors, Morningstar. Data as of June 30, 2023.

Figure 10. Consistency of performance (per cent)



	1 month	3 months	6 months	YTD	1 year	3 years (ann.)	5 years (ann.)	10 years (ann.)
Aviva Investors Global Equity Income (gross, GBP)	1.6	4.7	9.3	9.3	20.0	15.6	12.1	12.5
Aviva Investors Global Equity Income (net, GBP)	1.5	4.4	8.7	8.7	18.7	14.3	10.8	10.9
MSCI ACWI	3.1	3.3	7.8	7.8	11.3	9.9	9.2	11.1
Relative to index (gross)	**-1.5**	**1.4**	**1.4**	**1.4**	**7.8**	**5.1**	**2.7**	**1.2**

Past performance is not a reliable guide to future performance

Note: Performance shown for the Aviva Investors Global Equity Income Composite. Inception date of the strategy is March 31, 2013.

Source: Aviva Investors, B-One. Data as of June 30, 2023.

Aviva Investors Global Equity Income strategy: Key features

Our strategy aims to provide clients with a stable yield as well as a more resilient capital and income growth profile.

- ✓ **Distinctive elements:** A focus on downside protection, predictable cashflows and non-traditional parts of the market where we seek opportunities for income growth.
- ✓ **Differentiated and complementary positioning versus peers:** Higher weightings in growth-oriented sectors such as technology and industrials.
- ✓ **More effective in capturing upside than peers:** We believe our investment philosophy and the type of businesses we invest in will translate into higher dividend growth for clients.
- ✓ **Proven track record:** Top-decile performance over three, five and ten years.
- ✓ **An established team:** The portfolio manager works alongside a large and experienced equity team, backed by a well-established, centralised equity research function.

References

1. EBITDA: Earnings before interest, taxes, depreciation and amortisation.
2. GAAP: Generally accepted accounting principles.
3. Stock market data used in: Robert J. Shiller, "Irrational exuberance", Princeton University Press, 2000, 2005, 2015, updated.
4. The investment manager always applies the Firm's Baseline Exclusions Policy and any specific constraints within a prospectus or IMA, but any other ESG factors or risk considerations are adopted at the manager's discretion.
5. Versus the IA Global Equity Income sector, as well as prominent Global Equity Income peers based on AUM, net flow and prominent Aviva Investors sales team activity for a representative portfolio in the Aviva Investors Global Equity Income strategy, net of fees, GBP using Morningstar Direct. Morningstar upside capture ratio definition: Upside capture ratio measures a strategy's performance in up markets relative to an index. A value over 100 indicates that an investment has outperformed the benchmark during periods of positive returns for the benchmark.

Key risks

Investment risk and currency risk

The value of an investment and any income from it can go down as well as up and can fluctuate in response to changes in currency exchange rates. Investors may not get back the original amount invested.

Illiquid securities risk

Certain assets held in the strategy could be hard to value or to sell at a desired time or at a price considered to be fair (especially in large quantities), and as a result their prices could be very volatile.

Full information on risks applicable to the strategy are in the Prospectus and the Key Investor Information Document (KIID).

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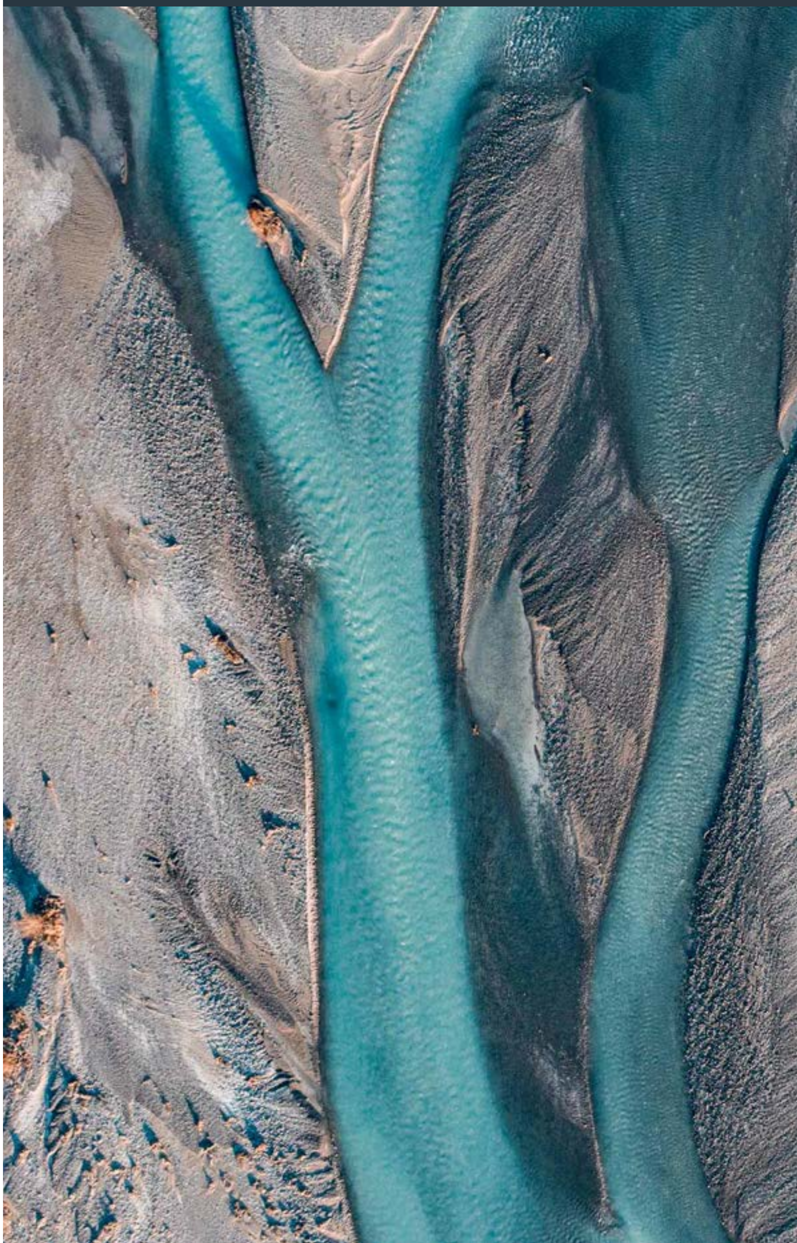

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Where relevant, information on our approach to the sustainability aspects of the strategy and the Sustainable Finance disclosure regulation (SFDR) including policies and procedures can be found on the following link: https://www.avivainvestors.com/en-gb/capabilities/sustainable-finance-disclosure-regulation/

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