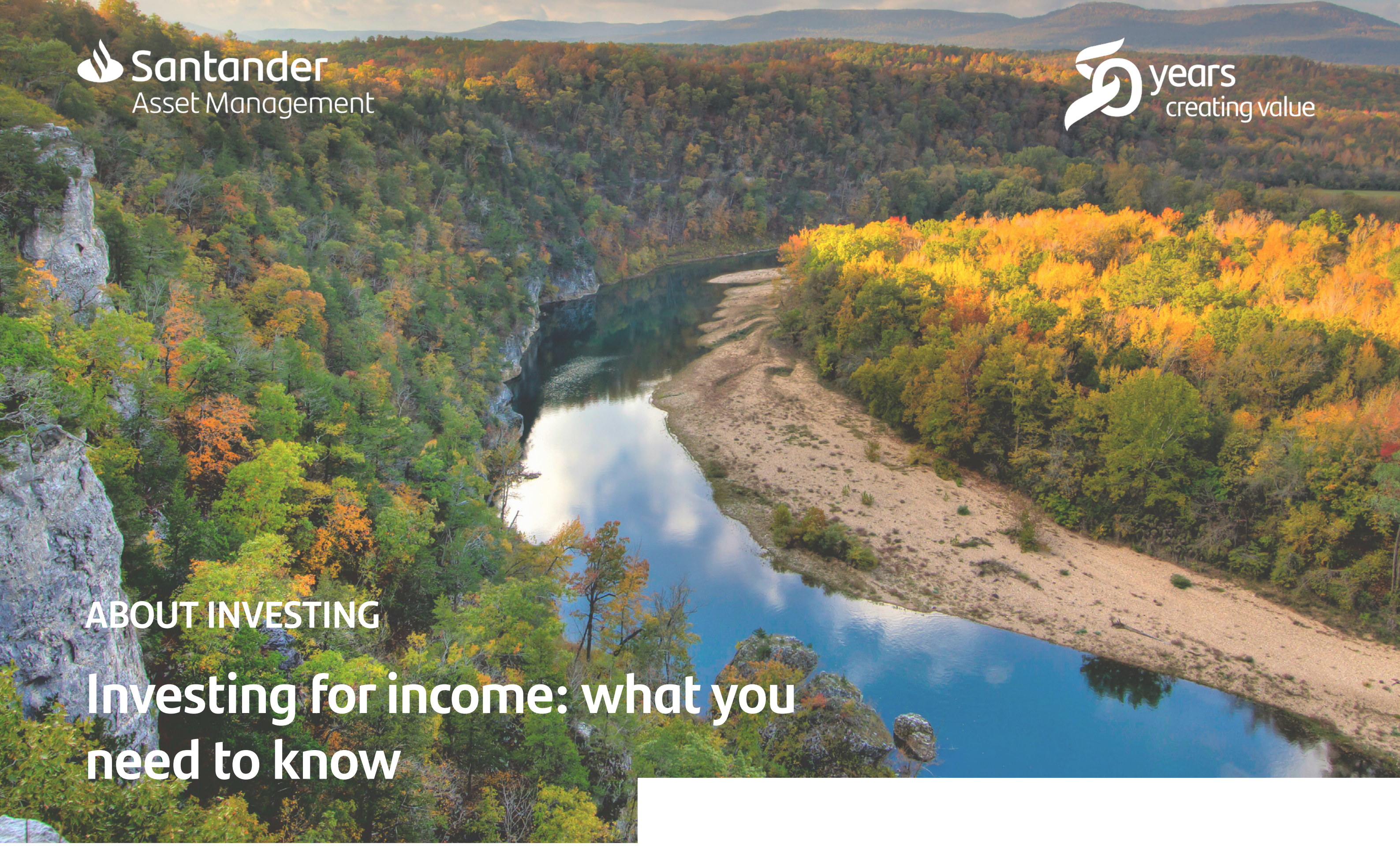

ABOUT INVESTING

Investing for income: what you need to know

While taking income from investments is often linked with retirement, there may be other times when it proves useful – if you are unable to work for a time or wish to top up your income for any reason.

Here we look at some important things to be aware of if you're investing for income.

How income funds work

Investment funds that focus on providing you with an income will generally include a mix of dividend paying shares and interest paying bonds (both government and corporate) to balance out risk and the potential for long-term growth. You might find an income fund's asset allocation also includes commercial property, which generates income from rent, and some cash to avoid having to sell assets to provide income when the markets are lower.

Rising to the challenge of changing market conditions

Recent market conditions have meant some challenges for income funds. Dividends from shares fell away during the pandemic with the UK Dividend Monitor Q1 2021 report from the Link Group putting total lost dividends during the previous 12 months at £44.8bn.[1]

The role of bonds in a portfolio is to balance out the risk of shares, but low returns mean they haven't necessarily been doing so. Commercial property is also under pressure with a shift to home working and online shopping during the pandemic impacting the outlook for that sector.

By April 2021 the prospects for dividends at least seemed to be more promising and Link Group's Q2 UK Dividend Monitor report showed dividends jump by 51.2% in the period to 30 June 2021.[2] Economies opening up from the latest COVID-19 lockdown has even prompted talk of a UK 'super dividend'. In the US several major banks were among companies announcing increased dividends.

What is not yet clear is whether this is a short-term rebound or a more long-term development. In any case, income fund managers are always looking to good future sources of income for their investors.

Generating a regular, reliable income

There are two main options for generating income from investments. The first is to rely on natural income, generated in the form of dividends and interest payments. The second option, the 'total return approach', means income is potentially taken from all sources (dividends, interest payments and any growth in the fund).

Whichever approach is favoured by a fund, the underlying investments chosen by its managers will pay income to the fund within different intervals, generally either monthly, quarterly, half yearly or even annually. Therefore, these payments will fall at different times in the fund year and in different amounts. Market volatility can also mean that these income payments, along with any growth in the fund, are unpredictable.

Income fund managers may use various techniques to smooth out income volatility, aiming to provide some stability of income to their investors. For example, using past and expected distributions the manager can estimate the expected average income which is then applied to smooth income payments to investors.

While smoothing gives investors some predictability in their income, which can help with financial planning, it does not guarantee reduced volatility. Smoothed income payments can be adjusted up or down in some market circumstances.

If a fund uses smoothing this should be clear from its Key Investor Information Document (KIID) or Key Investor Document (KID).

What is smoothing?

Levelling out income distributions throughout the year so that investors are not impacted by seasonality on payments and can get greater certainty on the expected periodic level of income. This can involve both, distribution of income in arrears or advance of the fund having received the income from its underlying investments.

Keep an eye on the markets if you're taking income

When taking income from your investments, it's important to be aware of how the markets are performing. If you're relying on natural income from one or more funds this may affect how much you can expect to receive. If you're selling units to help generate your income, when the markets are lower each may be worth less, so you may have to sell more of them.

Depending on the severity of the downturn this could have a significant impact on the value of your fund. It also means you have fewer units to benefit from the recovery that usually follows a downturn, making it harder for your fund to grow again. This effect is often called 'pound cost ravaging' or 'sequence risk'.

Making sure your investments don't run out

Whatever your personal investment portfolio looks like, it's important to make sure it lasts as long as you need it to. One way of approaching this is using a 'safe' or 'sustainable' withdrawal rate. It is worthwhile to check and see how consistently your investment has delivered income.

Getting the support you need

It's always worth considering financial advice, but it can be crucial when it comes to taking income from your investments. There's a lot to think about and keep track of, and you may find the support and expertise of a professional financial adviser invaluable.

Learn more

Stay up-to-date with our latest **Markets and Insights** at **santanderassetmanagement.co.uk**.

[1]Link Group – UK Dividend Monitor Q1 2021
[2]Link Group – UK Dividend Monitor Q2 2021
[3]CNBC, Retiring soon? Why the popular 4% withdrawal rule may be a bad idea, 13/4/2021

Let's be clear!

Investment terms explained

Bonds: A bond is a loan issued by a government or a company. When you buy a bond, the issuer promises to pay a certain amount of income until the bond redeems and is repaid by the issuer. The strength of that promise varies by the issuer of the bond. This is known as creditworthiness.

Dividend: The income you can earn from equities.

Income: The objective of the fund is to provide regular dividend payments to the investor now rather than the primary objective of long-term growth.

Portfolio: A group of investments that are managed together to meet a particular objective.

Property: Property may be difficult to sell and can demonstrate significant declines in value due to changes in economic conditions and interest rates.

Shares (often referred to as equities or stocks): In investing, this is a share of ownership in a company. Investing in a fund gives exposure to underlying share prices without investors actually owning the shares themselves.

Smoothing: Levelling out income distributions throughout the year so that investors are not impacted by seasonality on payments and can get greater certainty on the expected periodic level of income. This can involve both, distribution of income in arrears or advance of the fund having received the income from its underlying investments.

Volatility: The extent to which the value of an investment fluctuates over time.