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Please submit questions via the Zoom interface

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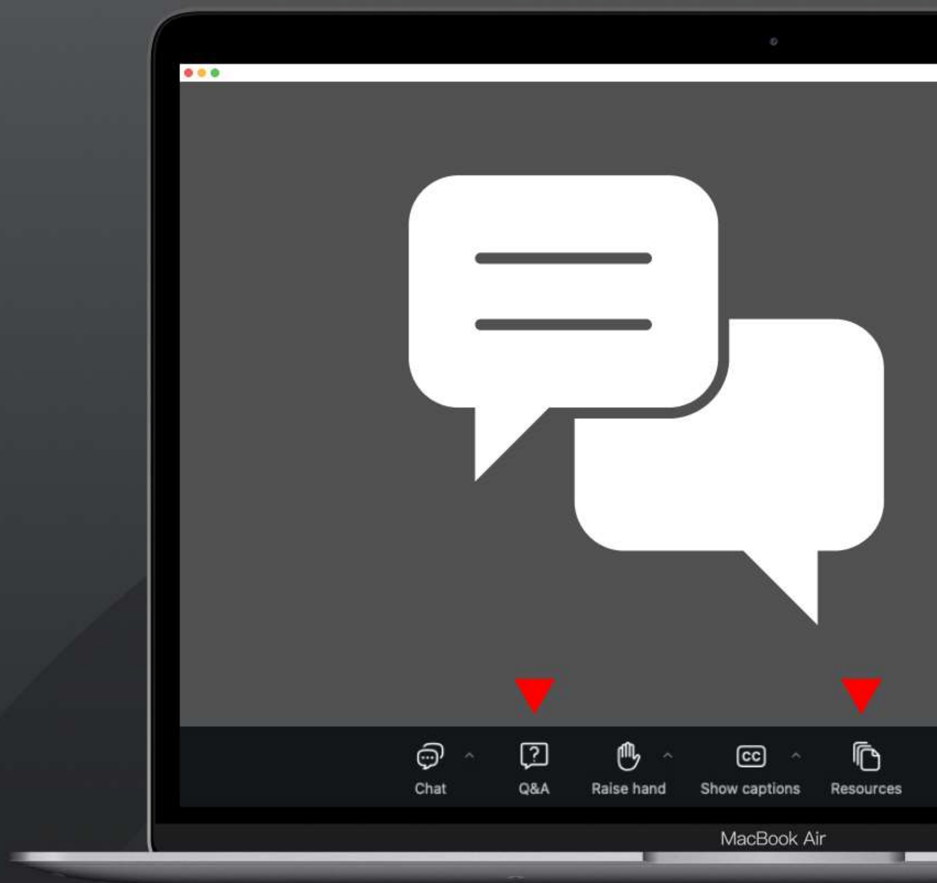

Morningstar retirement bootcamp

Tuesday 22 October | The case for and against income investing

Income investing remains controversial with some professional investors. We will walk through the arguments for and against income investing and if investors should consider pursuing this strategy.

Tuesday 29 October | Building an income portfolio

Investors love dividends but creating an income stream involves more than just picking the highest yielding shares. We will walk through the process to put together a portfolio.

Tuesday 12 November | Assessing individual income shares

A step-by-step process for assessing individual shares that can maintain and grow dividends.

Tuesday 19 November | Using ETFs to generate income

The structure of many dividend ETFs leads to lacklustre or non-existent dividend growth. Learn how to use ETFs as part of an income portfolio

Learning objectives

1. Understand the drivers of overall income growth and the different types of securities that should be considered for inclusion based on investor goals.

What is an income portfolio?

A portfolio is a collection of individual assets that is designed to help you achieve your investment goals. The assets in your portfolio should be aligned to your goals so while your portfolio needs to be diversified there is no need to own assets that don't align to what you want to achieve.

At the extreme income investors typically fall into two categories:

Highest possible yields

Highest possible income growth

Most income investors typically fall in the middle

Why most income investors need both high yields and growth

As investors we want to translate our surface goals into deeper goals because they better reflect what we actually want out of life and better inform our actions.

If your goal is to generate income from your portfolio what does that actually mean:

- Do you want a passive income stream to support spending while you are working?
- Do you want passive income to allow you to retire early as a bridge to super?
- Do you want to remove sequencing risk during retirement in super?
- Do you want to leave a legacy by only spending income and leaving principal invested?

Arguably the first three of these goals require a focus on building a portfolio of both dividend growth and high yielding securities. Almost all income investors benefit from at least maintaining and ideally growing the purchasing power of a passive income stream over time. This requires at least keeping pace with inflation.

Consideration 1: How much your overall passive income grows

There are three ways to grow a passive income stream:

1. **Saving and investing more:** This is a function of how much you can save but also how large your portfolio is relative to your savings. Typically, the contribution from savings drops as you age and your portfolio grows larger.
2. **Dividend growth:** This is a function of the types of investments held in your portfolio. Typically, as you age this makes up a larger contribution of your total income growth.
3. **Reinvestment of dividends:** This is a function of your portfolios yield and the yield that the income is reinvested. In rising markets with higher valuations and lower yields the contribution from dividend reinvestment will drop.

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Morningstar passive income projection tool

Consideration 2: The dividend yield vs growth trade-off

- All relative valuation levels including dividend yields reflect investor expectations about the future. Therefore, investors generally must make a trade-off between higher yields and higher dividend growth.
- Investor timelines, the growth differential and the yield differential will impact which option will provide investors with the highest amount of passive income in the future.
- For instance, with a 10-year time frame a share yielding 3% with 6.29% growth would provide more income than a share yielding 5% with 1% growth in dividends.
- A real-world example is an investor considering CSL or TLS in 2014. CSL was yielding 1.43% and TLS was yielding 4.94%. Today the investor that bought $10,000 of CSL would generate $575 in income. The TLS investor would generate $342 in income. This is an extreme example given how well CSL has done and how poorly TLS is doing but is illustrative of the point that growth eventually overtakes a higher yield.

Income investing spreadsheet

Consideration 3: The yield trap

- Dividend yields are backwards looking measures as they represent the dividends that have been paid in the past. High dividend yields may indicate that investors lake confidence that a dividend can be maintained into the future.
- For an income investor the yield may be an initial metric to find shares or ETFs to consider. However, without a fundamental analysis of the company it is impossible to determine if the opportunity is suitable to meet an investor’s goals.

Consideration 4: Diversification

- The point of diversification is to limit the risk of achieving your investment goal. That is the context investors should think about when making decisions on individual position sizes and exposure to different drivers of returns – geographic, asset class, etc.
- In an income investing context we need to not just look at diversification through the lens of position sizes but also a percentage of income perspective – particularly if the income is currently being spent to support your life.

Consideration 5: Measuring success

If your goal is to generate income – higher yields or dividend growth – it is critical to assess success based on that factor. Yield at cost is a measure I use to evaluate positions in my portfolio as it shows what I am getting out of each dollar I invested in a share or ETF.

Category	Yield at cost	Purchase date	Current yield
Automatic data processing	500%	May 1981	1.94%
Cisco	7.92%	August 2013	2.88%
Diageo	7.39%	April 2008	3.10%
Brookfield Infrastructure	8.17%	December 2013	4.51%
PepsiCo	11.29%	December 2008	3.05%
Johnson & Johnson	10.53%	August 2009	3.02%
Philip Morris	34.41%	June 2002	4.02%
Microsoft	9.97%	November 2009	0.70%
Vanguard Australian Shares High Yield	5.86%	June 2023	5.31%
American Tower	3.57%	September 2022	2.94%