# An alternative approach to finding income


For investors seeking to draw an income from their investments, traditionally, there have been two routes: interest payments on bonds, and dividends paid on shares. Today, though, with yields on bonds at ultra-low levels, bond markets are no longer a generous source of income for investors, pushing some investors into taking more risk via high dividend-paying shares.

Unfortunately, 2020 brought about unprecedented risks to dividend investing, when even companies with sound balance sheets were forced (least not by regulatory and political pressure) to cancel their dividend payments to shareholders.

Both bonds and shares are still capable of providing attractive returns, if investors know where to look, but more creative and pragmatic thinkers are increasingly turning to alternative types of assets to supplement their income streams. Here, we highlight some of the alternative assets – beyond traditional stock and bond markets – at work in our income strategies.

## Pushing the boat out: investing in the shipping industry

Shipping has long been a fiercely competitive industry, marked by narrow profit margins and unreliable customers. But when the pandemic hit, everything changed. Following an initial drop in economic activity (and the sudden closure of many international ports), demand for containerships soon rebounded strongly. Shipping prices skyrocketed, pushed upwards by supply chains in disarray alongside heighted demand for consumer goods, as shoppers looked to spend their saved lockdown cash and businesses aimed to rebuild their inventories.

Today, shipping costs have started to ease off a little, but remain far above their pre-pandemic levels. The adjustment back down to significantly lower pricing is likely to take years, rather than weeks or months. The ongoing global economic recovery will depend on a reliable and sustainable shipping system, and this is encouraging news for investors looking for long-term income streams.

There are of course threats to the global shipping industry, including political pressure to 'reshore' manufacturing (in the US, for example). However, the total reshoring of industries to their home markets would be extremely complex, and prohibitively expensive. Global manufacturing supply chains are likely here to stay, even if adjustments need to be made. For now, shipping businesses have time and income to plan for the future of freight. The savviest will take this opportunity to grow and diversify their businesses, as well as making climate-friendly adjustments to their vessels – something we are already seeing among our own investments in this area.

In this current inflationary environment, it is also worth noting that shipping assets tend to perform well in periods of higher inflation (though this may be because higher shipping rates themselves help to drive inflation upwards). Historical data shows that the value of existing vessels also tends to appreciate in an inflationary environment, reflecting the higher shipping rates generating so much income for the sector.

## Bricks and mortar with a twist: alternative property assets

It likely goes without saying that property is a vast and complex investable area, and one which lies beyond traditional bond and stock markets. One area of particular interest to us is the urban warehouse and industrial space. Consumer shopping and spending habits have evolved rapidly in recent years – accelerated by the COVID-19 pandemic – and online shopping has become the norm. And as e-commerce takes an increasingly large slice of the retail pie, the demand for well-placed facilities and digitally-enabled warehouse space is ballooning.

This is a structural growth story. The change in consumer preferences is highly unlikely to be reversed, and meeting consumer needs and expectations requires quality industrial property. Rental growth in the industrials sector has been strong for a number of years, and currently benefits from an imbalance between supply and demand (industrial new-builds have been relatively few and far between). This is fortunate for income investors seeking regular and sustainable yield.

Investing in property has another obvious potential advantage: the value of the underlying asset – in essence, the 'bricks and mortar' factor. But not all property is created equal, and we are extremely picky about which property assets gain a place in our income strategies.

## You use it, you pay for it: investing in royalties

Investing in royalties can sound like a strange concept, but royalty investments present a very attractive way of receiving a regular income. A royalty is a payment made to the owner of an asset – which could be intellectual property (e.g. a piece of music) – which the owner has licensed for use. By way of compensation, the owner is paid a portion of the net revenues received through the asset's use.

When we think of royalties, we probably think of the music industry, and this is certainly one way to access royalty income. Funds which own the rights to songwriters' intellectual property can collect royalties from the music's use, which includes placements in advertisements or film, or music streaming services.

The emergence of low cost streaming services (e.g. Spotify, Apple Music) has also reduced the appeal of illegal downloads, and has seen the music industry return to revenue growth. New technology platforms also mean that more revenue can be collected, and more efficiently.

Against this backdrop, long-term expected returns for our music royalty investments look attractive. Importantly for our income strategies, music royalties are not particularly sensitive to wider economic events. For example, while the music industry was not immune to the disruption and uncertainty caused by the COVID-19 pandemic, lockdown conditions provided a boost to streaming services, creating a more resilient income generation outlook. Beyond the lockdowns associated with the pandemic era, the outlook for music royalties looks promising because of good news for those who hold the rights to in-demand songs. In the all-important US market, the amount of music industry revenue being allocated to songwriters is increasing, by 44%, as mandated by changes in US law.

Other assets can also deliver royalties. Within our income strategies, we invest in royalty income from healthcare investments too. This typically relates to medical patents, with the fund owning a royalty stream in which a pharmaceutical firm compensates a patent-holder for the use of their intellectual property. Like music royalties, these investments typically have relatively low correlation to moves in the wider economy, and offer rewarding income in an environment where attractive yields are hard to come by.

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>
> Jaisal Pastakia, Investment Director

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