Elevate Your Equity Income: A Diversified Approach

> "Do you know the only thing that gives me pleasure? It's to see my dividends coming in."
>
> — JOHN D. ROCKEFELLER

Investors around the world have long shared Rockefeller's sentiment when it comes to dividends. Who could blame them? Dividends have traditionally been viewed as providing a reliable, steady stream of income that companies generally seek to protect regardless of the business environment. However, as we saw in 2020 during the height of the economic fallout of the COVID-19 pandemic, dividend payments can come under pressure.

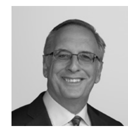
Today, high valuations have reduced dividend yields to the point where millions of investors, many of whom are retirees, are faced with a stark choice — accept levels of income insufficient to meet current needs or face unacceptable levels of risk in sustaining a given level of income. Neither option may be palatable, yet many investors remain trapped in traditional dividend-focused investment strategies that leave them fully exposed to this tradeoff.

In this note, we outline an alternative approach to equity income investing that can provide a potential solution to this predicament. Our approach uses additional methods beyond the selection of high-dividend-paying stocks to generate income, helping investors gain a better balance between expected portfolio yields and risk. Before we get into the details of our strategy, let's begin by taking a closer look at the risks inherent in the more traditionally managed equity income strategies.

Variability of dividends

Unlike the coupon payments received from bonds, dividend payments are not fixed by contract nor are they guaranteed. Put another way, companies are not obliged to make these payments. While many companies endeavor to preserve and grow their dividends, there are scenarios where dividends may be reduced or even suspended altogether. Dividend yields are also affected by market movements; if markets appreciate, yields go down. Each of these risks contribute to the inherent variability in dividend yields.

This variability can create challenges for investment strategies that rely solely on dividends to generate desired levels of income. To meet income targets, managers may be forced to sell high-conviction positions in favor of riskier positions that can deliver the income they need. This in turn could harm the integrity of the portfolio and reduce the total return potential of the strategy, especially if managers are forced sellers during a drawdown. To protect total returns in the long run, we believe it is often better to deliver lower portfolio yields with lower levels of risk. Thankfully, there are other ways to compensate for lower yields that will not harm the integrity of the portfolio — we discuss these next.



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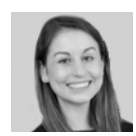

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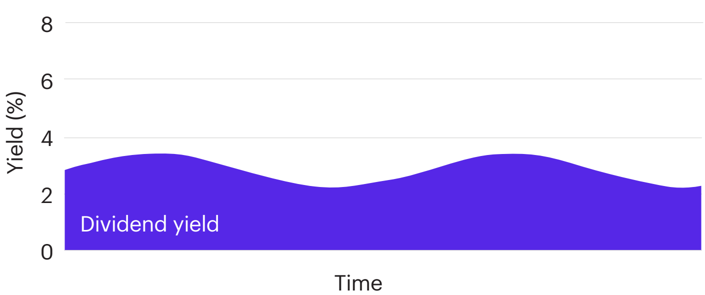
Delivering sustainable income from diversified sources

The Global Equity Enhanced Income (GEEI) approach differentiates itself from other dividend strategies by harvesting two diversifying sources of income. We combine the dividends from equities selected using our quantamental investment process with premiums from an actively managed systematic options overlay, together aiming to deliver a sustainable distribution yield typically in excess of 6% per year. The options overlay is dynamically managed to balance the required income with the preservation of upside, so as not to sacrifice upside when markets are accommodative.

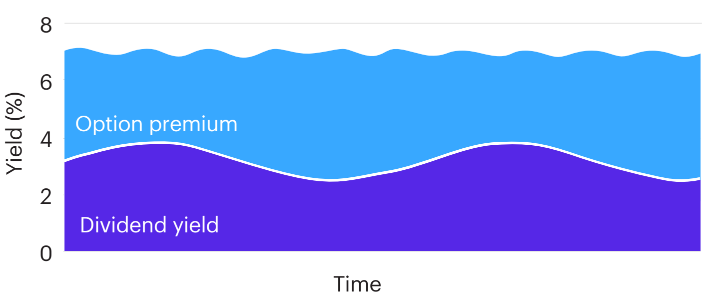
Under normal market conditions, most of the income generated by GEEI will be from the dividends of the underlying stocks. However, at other times, the yield on the equity portfolio will be lower to reduce the risk of forced selling into an unfavorable market environment. In this type of low-dividend environment, volatility is often elevated, making the premiums from selling call options more attractive. These higher option premiums can be viewed as income, supplementing yield from the underlying equity portfolio while providing a buffer against equity market volatility.

Figure 1 illustrates this concept. The proportion of distribution yield from the dividends and option premiums varies over time with market conditions, with each source delivering yield to meet the required distributions.

FIGURE 1:
GLOBAL EQUITIES AVERAGE YIELD: ~2.5%



GLOBAL EQUITIES ENHANCED INCOME AVERAGE YIELD: ~6.4%



Source: Allspring. For illustrative purposes only.

Building a stable dividend income stream without sacrificing return

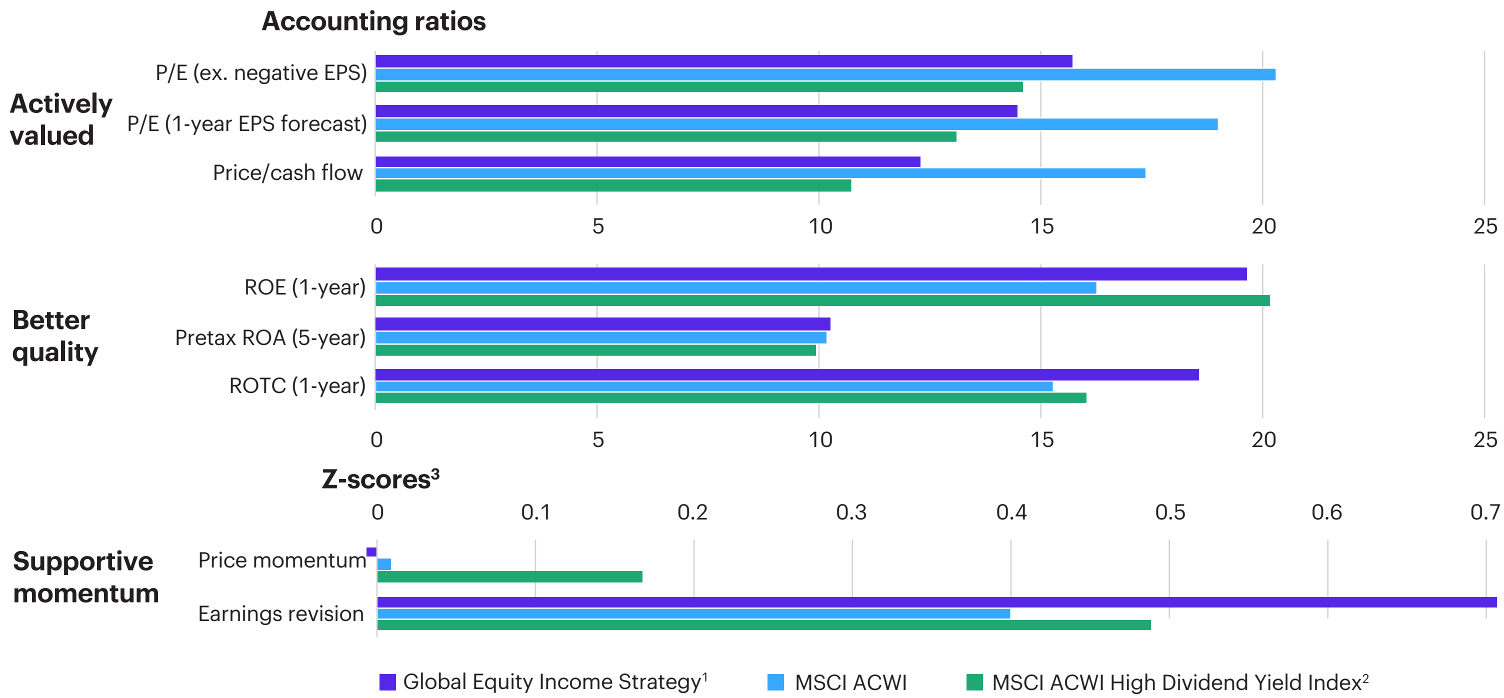
Our primary source of income is derived from a global equity portfolio that is supported by a proprietary, quantamental security selection process. The portfolio is designed to deliver significantly more dividend income than traditional equity benchmarks by selecting names that possess both high dividend yields and fundamentals that can sustainably support their dividend policies.

What does quantamental mean in practice? We use a quantitative model to assess thousands of companies and identify those that are attractively valued, deliver quality earnings, and have market support. We supplement this with fundamental analysis to build conviction in the names we want to buy.

Portfolio construction seeks to avoid the style biases and structural imbalances often seen in high-dividend strategies, which tend to result in portfolio-level imbalances in regional, sector, and factor exposures. Unlike typical dividend income strategies, we design the portfolio to provide income without sacrificing return. We may have an allocation of up to 10% to non-dividend-paying stocks as long as we are meeting the portfolio's dividend income objective and maintaining the desired regional, sector, and factor exposures. Additionally, we may hold names that we expect will implement or reinstate a dividend policy that would benefit the portfolio prior to the official announcement or declaration of the policy.

The resulting portfolio holds 60 to 80 names, targets a dividend yield of 1.5% to 2.0% above its benchmark (the MSCI All Country World Index), and maintains a beta of approximately 1 and benchmark-like regional and sector exposures. Figure 2 highlights these attributes.

FIGURE 2: OUR PROCESS RESULTS IN WHAT WE BELIEVE TO BE A BALANCED PORTFOLIO



1. This information is based on a representative account excluding cash within the Global Equity Income Composite. The representative account has been selected by meeting the following criteria: The account is in the Global Equity Income Composite and Allspring represents that the holdings, characteristics, and risk profile are representative of the strategy/style of the Global Equity Income Composite. Any changes to the representative account must be approved by Investment Analytics. Source: Allspring. Index source: FactSet.
2. The MSCI ACWI High Dividend Yield Index is shown for comparative purposes to reflect the strategy's objective of delivering dividend income.
3. Source: Systematic Edge team. Index source: FactSet. Data presented as of December 2021.

The insights we've gained on the stocks in our portfolio provide conviction on the dividend-supporting fundamentals of each holding and give us confidence in forecasting each stock's contribution to portfolio yield. This analysis is then fed back into the portfolio design process to ensure that any additional yield needed to meet the target can be achieved.

Enhancing income with actively managed options

To further enhance the yield of the portfolio, we employ an actively managed options overlay. Income is generated by harvesting the premiums received from selling call options in exchange for sacrificing some future potential upside. The option overlay is dynamically managed to balance the required income with the preservation of upside return potential.

We sell index-level options to preserve the stock-specific upside within the portfolio. We believe the names in our portfolio are undervalued, and we want to harvest the potential appreciation benefits from stock selection. Furthermore, the mix of indexes that we sell options on closely replicates the aggregate exposures of our equity portfolio. The aim is for the equity portfolio and basket of options to track similar systemic risks, thereby maintaining a tight link between both legs of the portfolio.

The options strategy is dynamically managed so that we only sell enough options to generate the premium income required to meet the distribution target. When dividend income is lower, we seek to generate more option premium to make up the shortfall and provide investors with a stable, high level of income.

We use a proprietary enhanced systematic options process that provides the transparency and predictability of a systematic approach while actively selecting options that are, in our view, the most overpriced. Our options team has a long history of adding value using this process.

Is it time to reconsider your equity income strategy?

We believe investors' need for income is as important as it has ever been in today's low-yield, high-valuation environment. Being flexible in how income is sourced is a vital component in meeting this need. By managing income dynamically from two sources — dividends from equities and premiums from selling options — we believe we can deliver a sustainable level of income that is typically in excess of 6% per year while maintaining significant upside participation.

The strategy we outlined in this note is one that we have pioneered and, as we've described, is differentiated from competing equity income strategies that rely on dividend income alone. Our strategy has generated a strong track record of delivering a sustainable income for our investors, and we have full conviction in our robust approach to navigate uncertain markets ahead.

Strategy profile: Global Equity Enhanced Income

INVESTMENT OBJECTIVE AND APPROACH

- The strategy seeks to deliver sustainable income of at least 6% distribution yield per annum and targets total return in line with the MSCI ACWI Index.*

Active stock selection

- We invest in a portfolio of carefully selected global stocks using a blend of quantitative tools and fundamental analysis to deliver attractive dividend yields.
- Our active stock selection seeks to avoid style biases and structural underweights often seen in high-dividend strategies.

Enhanced systematic options

- An actively managed enhanced systematic options overlay seeks to deliver additional income by selling call options, exchanging some upside potential for immediate income.
- We sell call options on indexes with the aim of preserving stock-specific upside within the equity portfolio.

Dynamically managed

- The two sources of income are dynamically managed to meet the distribution target, balancing the sources of income in a market-aware manner and respecting the objective of providing total return and income.

Benchmark: MSCI All Country World Index

Inception date: August 1, 2020

STRATEGY RISKS

- **Market risk:** Securities may decline in value due to factors affecting securities markets generally, and equity securities generally have greater price volatility than debt securities.
- **Smaller company security risk:** Securities of companies with smaller market capitalizations tend to be more volatile and less liquid than securities of larger companies.
- **Geographic concentration risk:** Investments concentrated in specific geographic regions and markets may be subject to greater volatility due to economic downturns and other factors affecting the specific geographic regions.
- **Global investment risk:** Securities of certain jurisdictions may experience more rapid and extreme changes in value and may be affected by uncertainties such as international political developments, currency fluctuations, and other developments in the laws and regulations of countries in which an investment may be made.
- **Derivatives risk:** The use of derivatives presents risks different from, and possibly greater than, the risks associated with investing directly in traditional securities. The use of derivatives can lead to losses because of adverse movements in the price or value of the underlying asset, index, or rate, which may be magnified by certain features of the derivatives.

*A target is indicative only, not guaranteed, and does not take into account fees or charges that will reduce returns.

To learn more

We want to help clients build for successful outcomes, defend portfolios against uncertainty, and create long-term financial well-being. To learn more, investment professionals can contact us.

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