INVESTMENT REPORT

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INCOME FUNDS: A BETTER MONEY MARKET ALTERNATIVE

By Danine van Zyl, Financial Advisor Brenthurst Wealth Fourways

IN THIS ISSUE

"Income funds aim to provide a return higher than money market returns and to earn a reasonable level of income with relative capital stability and low risk."

Since the outbreak of the Covid-19 pandemic in March 2020 and, more recently, the war between Russia and Ukraine, markets have been very volatile, causing emotional and risk-averse investors to look for safer/lower risk investment alternatives. Consequently, many investors have been selling out of stock markets and transferring their capital to money market investments. However, the real returns offered by money market investments can simply not beat inflation at current levels of 5.90%, whilst the interest rate in SA is a meagre 4.25%.

An alternative investment option to money markets are income funds. Their objective is to provide a return higher than money market returns and to earn a reasonable level of income with relative capital stability and low risk.

These funds enjoy a flexible mandate in that the fund managers will look for opportunities to invest in money market instruments, different types of bonds, such as inflation-linked, floating rate, fixed interest, preference shares and property.

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Income funds should surely be considered as part of an investment portfolio, given the excellent risk-adjusted returns and lower volatility compared to other asset classes, especially while markets are so volatile.

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WHAT ARE THE RISKS?

INTEREST RATE RISK

The risk to which a portfolio or institution is exposed due to the uncertainty of future interest rates. Due to the interest rate sensitivity of bond prices, the present value of a bond will fall should interest rates rise. Interest rate risk, therefore, refers to the effect of changes in the prevailing market rate on the return of a bond, and comprises price and investment risk.

INFLATION RISKS

The risk is that when inflation rises it will lower the purchasing power of your income.

CREDIT RISK

The risk that the creditworthiness of a bond issuer will deteriorate, increasing the required return on that bond and decreasing its value. Credit risk includes the risk of default, credit spread and downgrade risk.

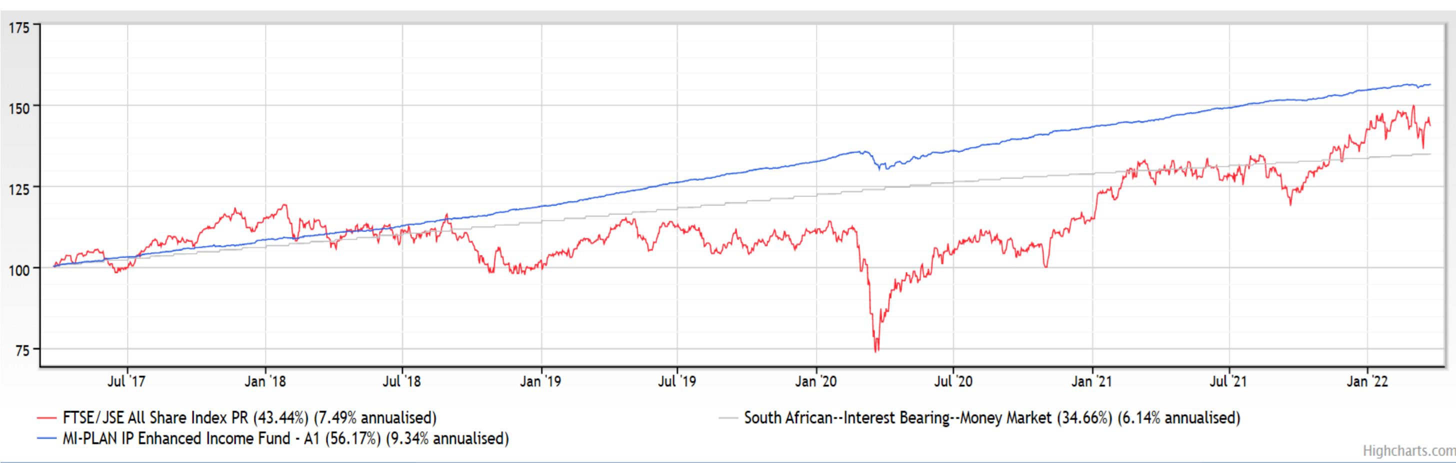
LIQUIDITY RISK

The risk in bonds is as a result of the difficulty of selling securities quickly at an attractive price. This only applies to the investor who is looking to sell their bonds before the maturity date. Investors who keep their bond until maturity will receive the principle of the bond plus interest on its face value.

When advisors include income funds in portfolios, where appropriate, a preferred fund to use is the Mi-Plan IP Enhanced Income Fund, which has successfully outperformed the JSE and provided greater returns than equity over the past five years, and with much less volatility.

The Mi-Plan IP Enhanced Income Fund is a typical income fund that is used for investors seeking options in fixed income funds. The fund currently includes government bonds (42.59%), corporate bonds (55.32%), securities (1.43%), cash and cash equivalents (0.66%).

THE FUND'S SUPERIOR PERFORMANCE COMPARED TO THE JSE AND SOUTH AFRICAN INTEREST-BEARING MONEY MARKET OVER THE PAST FIVE YEARS IS ILLUSTRATED GRAPHICALLY BELOW:



In March 2020 South Africa experienced the sharpest correction in the local bond market in the past five years. Despite this downturn, investors were still able to receive a positive return.

CONCLUSION

Income funds should surely be considered as part of an investment portfolio, given the excellent risk-adjusted returns and lower volatility compared to other asset classes, especially while markets are so volatile. The percentage asset allocation to these funds will depend on the investor's specific risk profile, income requirements and time horizon.

ADVISOR PROFILE

DANINE VAN ZYL | FINANCIAL PLANNER AT BRENTHURST FOURWAYS

DANINE joined Brenthurst Wealth in 2015 and currently holds the position as a Financial Advisor at the Fourways Office.

She completed her Post-graduate Diploma in Financial Planning from the University of the Free State and also obtained a B.A. degree in Industrial Psychology, a Certificate in Labour Relations Management and Income Tax.

Danine has also successfully completed the First Level Regulatory Examination for Representatives. She is a member of the Financial Planning Institute of SA and is fully qualified to advise on all investment matters.

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