Understanding Distribution of Income from Unit Trust Funds

A unit trust fund distributes income to its investors in line with its published distribution policy. Generally, fixed income/bond funds pay distributions to their investors on a regular basis, e.g. annually. On the other hand, the distribution policy for most equity funds is incidental, which means that the fund's distribution of income is optional. However, selected equity (dividend funds), balanced and mixed asset funds have the objective to provide income (which may be in addition to the objective of achieving long-term capital growth) and will generally have an annual/semi-annual distribution policy.

As such, an evaluation of a unit trust fund should be undertaken with the fund's objective in mind – be it capital growth, provision of income, or both – with its performance assessed based on its total return (comprising capital gains and income distribution, if any). This is because the total return incorporates the appreciation in the fund's net asset value (NAV) as well as unit splits and the distribution of income made to investors. In comparison, distribution yields only capture part of the total return.

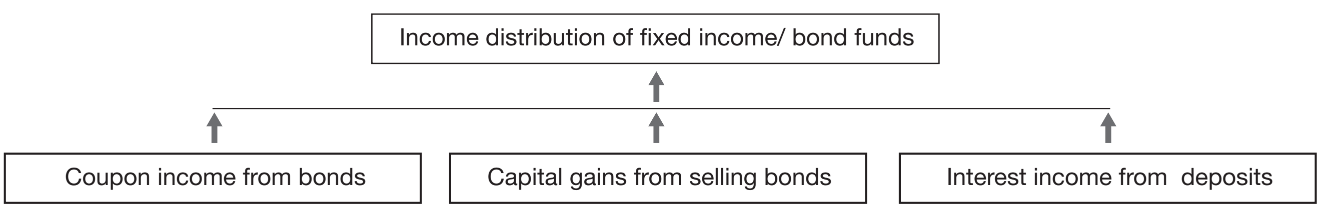
In terms of the income distributions of unit trust funds, it is worth noting that fixed income/bond funds and dividend-focused equity funds largely derive their income for distributions from different sources, while balanced/mixed asset funds derive their income for distributions from a combination of the aforementioned types of funds.

1. Breakdown of Income Distribution for Fixed Income/Bond Funds

Fixed income/bond funds derive their income for distributions primarily from three sources:

i. Coupon payments from sovereign bonds and/or corporate bonds;
ii. Capital gains from selling bonds that have appreciated in value; and
iii. Interest income from deposit placements and money market instruments.

Chart 1: Income Components of Fixed Income/Bond Funds



Generally, fixed income/bond funds pay distributions to unitholders on a fixed schedule (e.g. annually). This is because bond issuers – usually government entities and corporations – are obliged to pay interest/coupon payments at fixed intervals as well as to repay the principal upon maturity of the bonds.

In addition, deposits placed with licensed financial institutions and money market instruments are low-risk investments that provide stable interest income while preserving the nominal capital value. These features make fixed income/bond funds an appropriate choice for unit trust investors seeking to receive stable income with a lower level of risk as compared to equity funds.

However, it should be noted that capital gains of fixed income/bond funds are subject to interest rate movements. A rise in interest rates generally leads to a fall in bond prices, which could in turn impact the amount of capital gains generated by fixed income/bond funds. Conversely, when interest rates decline, bond prices appreciate and the funds are more able to generate a higher quantum of capital gains.

Hence, unit trust investors are advised to stay invested over the medium to long term to ride out the short-term volatility of the bond market, as fixed income/bond funds tend to be able to provide a steady and regular stream of income through coupon receipts and active portfolio management over time.

2. Breakdown of Income Distribution for Dividend-focused Equity Funds

The distribution of income for dividend-focused equity funds is obtained primarily from realised capital gains and realised income. Capital gains are realised when the fund sells its investments that have appreciated in value, while realised income comprises dividend income from the fund's equity investments as well as interest income from its money market investments.

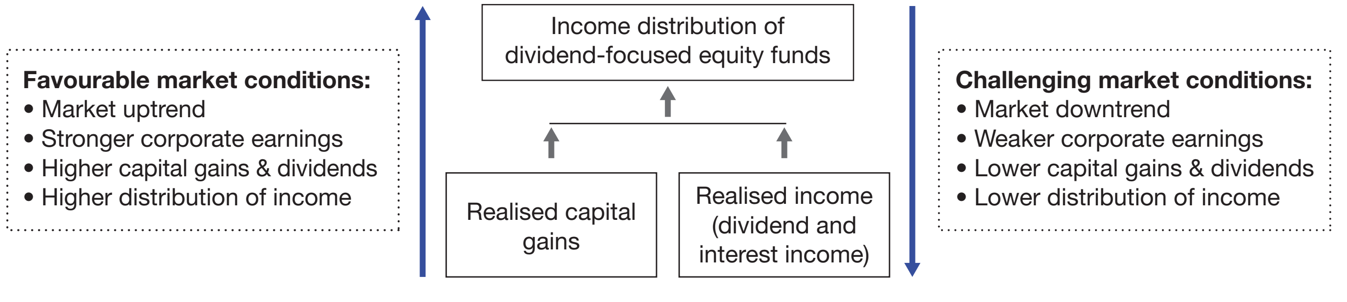
In any particular year, the distribution of income from dividend-focused equity funds depends on the impact of market conditions on the funds' realised gains and/or realised income for the year.

When the market is in an uptrend, dividend-focused equity funds are capable of generating a higher quantum of capital gains. The funds may also receive higher dividends paid by investee companies due to the latter's stronger corporate earnings. Dividend-focused equity funds are therefore better able to declare a higher distribution of income when market conditions are favourable.

In contrast, when the market is in a downtrend, dividend-focused equity funds generally have a lower quantum of income for distribution purposes; primarily due to lower capital gains generated by the funds amid elevated market volatility. Secondly, challenging economic conditions may also lead to weaker corporate earnings, prompting companies to reduce their dividends in order to conserve their cash flow. Taken together, the lower capital gains realised by dividend-focused equity funds and the reduced dividend income received by the funds will affect the magnitude of the funds' distribution in that particular year.

Consequently, the amount of distributions declared by dividend-focused equity funds is subject to the quantum of the funds' realised gains and/or realised income in a particular year.

Chart 2: Income Components of Equity Funds



Conclusion

Given that the distribution of income payable by most equity funds is incidental, unit trust investors who require a quantum of regular income should ensure that their portfolios include fixed income/bond funds and/or equity/balanced/mixed asset funds which have the mandate to provide income. The allocation to these funds within the investors' portfolios should be higher if their need for distributions of income is more important.

Public Mutual offer a wide selection of bond/sukuk funds and equity/balanced/mixed asset funds with a mandate to provide income distributions that cater to investors' need for income (see Table 1). Before investing, investors should take into consideration the investment objectives and key features of these funds and ensure that these are in line with their investment needs and risk profiles. It is also important for investors to adopt a long-term investment horizon when investing in unit trust funds so as to ride through any short-term fluctuations in the equity and bond markets.

Table 1:

Equity/Balanced/Mixed Asset Funds with Distribution Mandates	Bond/Fixed Income Funds
Public Dividend Select Fund	Public Bond Fund
Public e-Asia Pacific REITs Flexi Fund	Public e-Income Fund
Public Far-East Dividend Fund	Public Enhanced Bond Fund
Public Far-East Property & Resorts Fund	Public Enterprises Bond Fund
Public Optimal Growth Fund	Public Select Bond Fund
Public Regular Savings Fund	Public Strategic Bond Fund
Public Regular Savings Sequel Fund	PB Bond Fund
Public Savings Fund	PB Fixed Income Fund
Public Select Mixed Asset Conservative Fund	PB Infrastructure Bond Fund
PB ASEAN Dividend Fund	Public e-Islamic Income Fund
PB ASEAN Dividend Sequel Fund	Public e-Sukuk Fund
PB Asia Pacific Dividend Fund	Public Islamic Bond Fund
PB Asia Real Estate Income Fund	Public Islamic Enhanced Bond Fund
PB Dividend Builder Equity Fund	Public Islamic Income Fund
PB Mixed Asset Conservative Fund	Public Islamic Infrastructure Bond Fund
Public Ehsan Mixed Asset Conservative Fund	Public Islamic Select Bond Fund
Public Islamic Asia Dividend Fund	Public Islamic Strategic Bond Fund
Public Islamic Dividend Fund	Public Sukuk Fund
Public Islamic Growth & Income Fund	PB Aiman Sukuk Fund
Public Islamic Optimal Growth Fund	PB Islamic Bond Fund
Public Islamic Savings Fund	PB Sukuk Fund
Private Retirement Scheme (PRS) Funds with Distribution Mandates	
Public Mutual PRS Conservative Fund	
Public Mutual PRS Islamic Conservative Fund	