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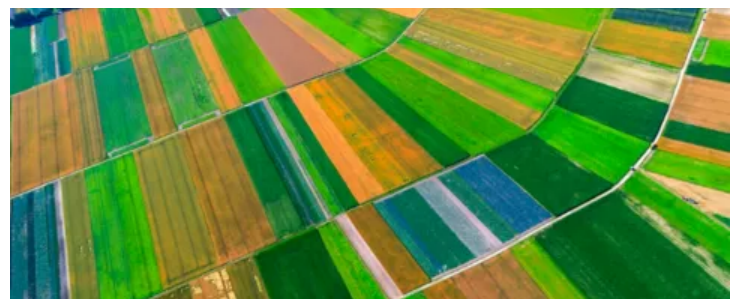


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## Why income-seeking investors need to look across asset classes

December 2023



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### In brief:

- With cash rates around 5%, the world of income has changed and relatively high levels of income can be achieved without taking as much risk as in the past.
- This should prompt investors to take a fresh look across asset classes to look for compelling opportunities.
- But remaining flexible is key — being dynamic can help investors navigate income opportunities as they arise.

If income were auditioning for a role in a portfolio, it might be considered a triple threat. No, not in its ability to act, sing or dance, but in its potential to deliver three key benefits: a regular cash flow, tax advantages and return consistency.

The last of these is often underappreciated, especially by investors focused on capital appreciation. Our

research suggests, however, that income can contribute more than half the returns for a standard 60% equity/40% bond portfolio over a five-year investment horizon. This percentage increases for asset classes with a higher income profile<sup>1</sup>.

The case for income is particularly pertinent now. With cash rates at around 5%, the world of income has changed, and relatively high levels of income can be achieved without taking as much risk as in the past. This should prompt investors to take a fresh look across asset classes to see where potential opportunities lie. For example, should investors look to increase the income target in their equity allocation or in their credit allocation?

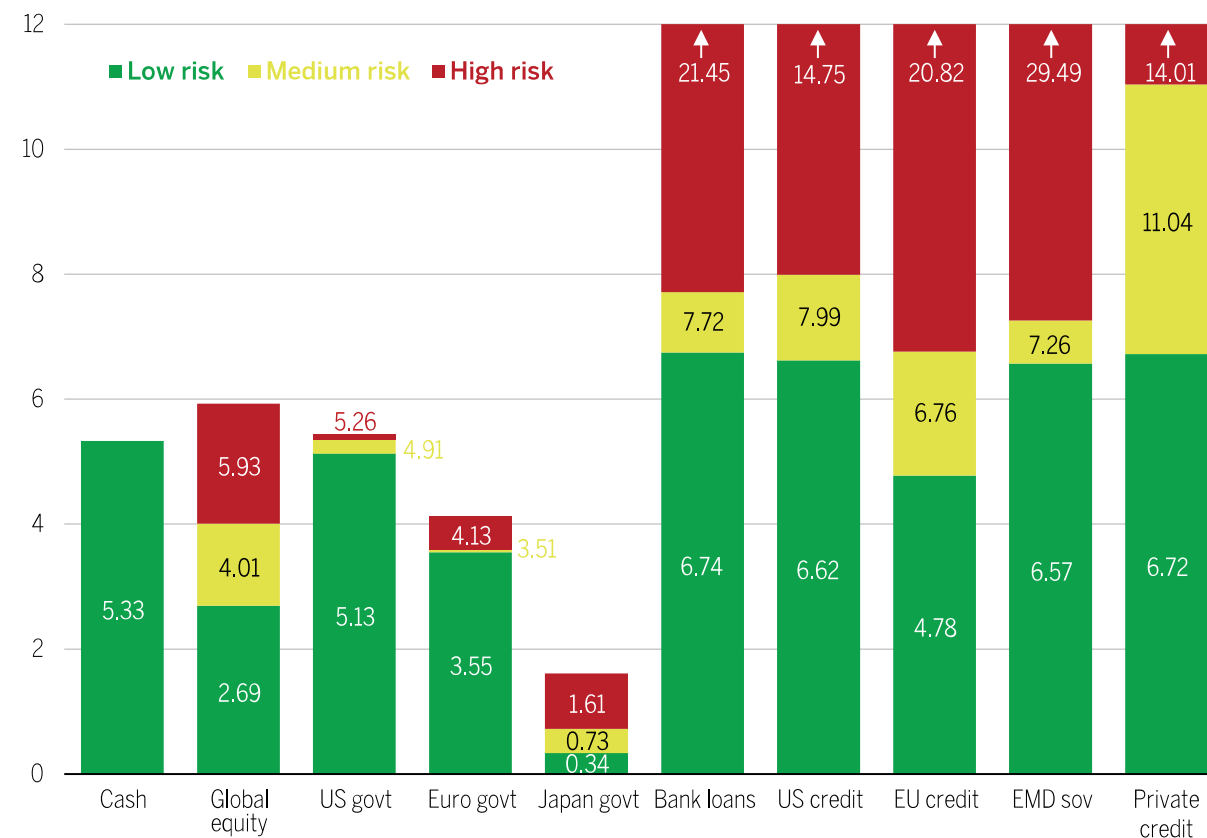
To determine the right answer for their portfolios, we believe investors need to understand how much potential income a given asset class can generate relative to the level of risk introduced. We suggest that investors use a framework, such as our *cross-asset risk and relative yield* or CARRY landscape (**Figure 1**).

The CARRY landscape uses the primary risks of each asset class in order to plot the current income level in exchange for taking low risk (green), medium risk (yellow) and high risk (red). This can help investors weigh opportunities against risks.

**Figure 1**

**The CARRY (cross-asset risk and relative yield) landscape**

Annual income (%)



Asset	Low	Medium	High
Key risk			
Equity Concentration	100% index	50% index	20% index

<b>DM govt bonds</b> Duration	1 – 5y	5 – 10y	10y+
<b>Credit</b> Credit risk	AAA – BBB	BB	B – CCC

Sources: Wellington Management, Refinitiv, Factset, Cliffwater. Data as at 31 October 2023. Private credit data as at 30 September 2023. Private credit data reprinted by permission of Bank of American Corporation (BAC). See additional disclosure at end of the article. Global equity data provided by Factset. For illustrative purposes only. PAST RESULTS ARE NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.

## Comparing different income sources across a portfolio

Each asset class differs in its potential to generate income and will also have a different primary risk associated with it. Within equities, stocks that pay higher dividends tend to cluster in specific industries such as oil and gas, financial services and telecoms. Targeting these stocks can shrink the opportunity set, introducing **concentration risk**. For fixed income, both government bonds and credit can offer attractive levels of income, which may also be accompanied by **duration risk** and **credit risk**, respectively.

### Figure 2

#### A risk vs income explainer

Asset class	Source of income	Primary risk
<b>Equities</b>	Dividend income, paid to shareholders out of a company's profits	Concentration risk from overexposure to certain sectors or regions
<b>Government bonds</b>	Income paid to bondholders at a fixed rate over a set period	Duration risk from a bond's sensitivity to interest-rate changes
<b>Credit bonds</b>	Income paid to bondholders at a fixed rate linked to the creditworthiness of the issuer	Credit risk from the risk that a borrower is unable to repay their lender

Source: Wellington Management.

## Putting this into practice

As **Figure 1** shows, seeking higher income within an asset class tends to shift risks into the yellow and red medium- and high-risk regions of the chart, and investors need to assess whether they are likely to be compensated for taking this risk.

For example, an investor seeking very high income from equities may be able to attain yields of up to 6%, but this level of income is only available by investing in a very concentrated part of the market and may therefore be deemed “high risk”. Alternatively, the same investor could access the same return potential by investing in lower-risk US or European credit. All other factors aside, investors only focused on income would likely opt for the less risky credit option. Having said that, we think it makes sense to diversify income sources across several asset classes given that they each offer unique characteristics that can help portfolios, for example, the potential for significant capital growth in equities. Of course, income opportunities and risks will change over time, so investors may benefit from a somewhat dynamic investment process.

## Bottom line

Looking across asset classes can help investors understand the most effective sources of income for their portfolios. However, income opportunities can evolve quickly, so being dynamic across multiple asset classes makes sense, to navigate opportunities as they arise.

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### Important disclosure

**BAC data in Figure 1** — The use of the data in no way implies that BAC or any of its affiliates endorses the views or interpretation or the use of such information or acts as any endorsement of the use of such information. The information is provided “as is” and neither BAC nor any of its affiliates warrants the accuracy or completeness of the information.

<sup>1</sup>Source: Wellington Management, “[Income investing in multi-asset portfolios: tipping the balance in your favour](#)”, September 2023,

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