INVESTOR

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Are your income sources producing responsible yield?

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For many investors, the wealth they accumulate over their lifetime will be needed to provide a steady flow of income throughout retirement.

But accumulating that nest egg has become harder amid stagnating wages, rising costs of housing and education, lower expected returns from capital markets, heavy household debt burdens, and fewer company pension plans. And as our lifespans get longer, our savings need to continue growing even after we retire, in order to provide sustainable income over a potentially lengthy period.

Investors who want to leave a legacy or establish a cushion for unexpected events such as a health issue, have an even greater need for portfolio growth as preservation of principal becomes paramount.

And all retirees share a need to get the most income possible without taking on too much risk.

The concept of "responsible yield" may go a long way to helping investors reach these complementary goals.

Yield is the income produced by an investment, generally in the form of interest or dividends. It's usually expressed as an annual percentage rate based on the investment's current market value. For example, a bond may offer a 3% yield, or the dividend paid on a company's stock may yield 4%. However, the payment of interest or a dividend can reduce the market value of the investment, which is why many experts suggest investors consider the "total return" from a portfolio, which takes into account capital gains as well as income.

Responsible yield encourages a level of yield that doesn't significantly reduce a portfolio's total expected return. In other words, responsible yield allows investors to obtain current income from their investments while still allowing the portfolio to keep growing to sustain future income.

In Exhibit 1, the solid blue line shows the maximum expected return on a portfolio for a specific level of yield. The dotted orange line highlights the frontier where the expected portfolio yield and return are equal. Portfolios which fall within the region where expected total returns are greater than expected yields, such as Portfolio 'A', are considered "responsible". Portfolios outside this range, such as Portfolio 'C', are considered "irresponsible" as they would distribute more in income than they earned from interest, dividends, and capital gains. That could make future yields at this level unsustainable as the too-high yield could erode capital.

In order for a portfolio to allow an investor to obtain responsible yield, the following basic criteria should be met:

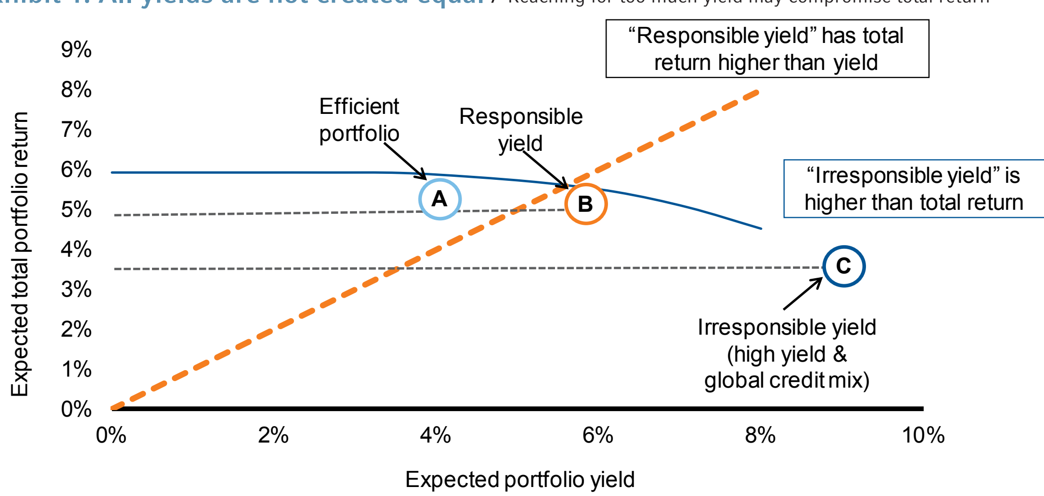
- It should produce sustainable cash flow over the spending horizon
- The cash flows should rise with the increased cost of living from inflation
- It should be diversified and efficient in such a way that it can provide income through any market environment
- The risk profile should be in line with the investor's stated risk tolerance

We believe a portfolio that produces responsible yield and meets the above criteria will result in the following:

Balance the income needs of today with growth for tomorrow

Since the portfolio is intended to help finance a retiree's lifestyle, the income produced should be dependable—to keep paying even if the assets themselves decline in value. Many retirees have three financial goals: generate enough money to live on each year, establish additional

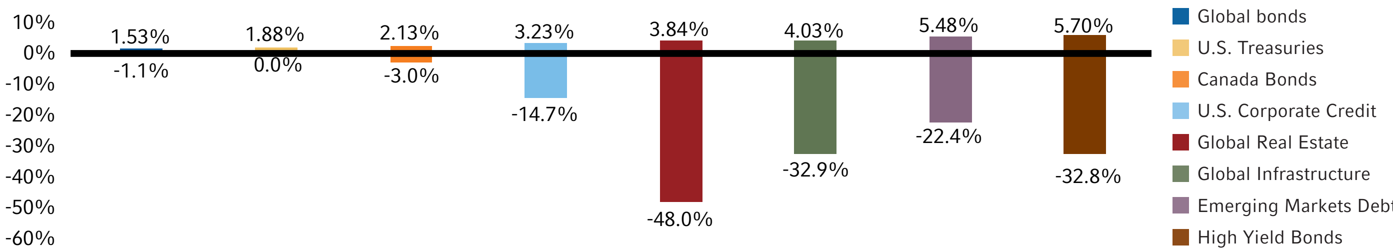
Exhibit 1: All yields are not created equal / Reaching for too much yield may compromise total return



Source: Russell Investments. For illustrative purposes only.

This analysis is hypothetical in nature, does not reflect actual investment results and is not a guarantee of future results.

Exhibit 2: Beware the risks of 'reaching for yield'



Source: Russell Investments. Data from January 1, 2006 to June 30, 2019.
Yield as of June 30, 2019.

Indexes are unmanaged and cannot be invested in directly. Past performance is not indicative of future results.

Global bonds=Bloomberg Barclays Global Aggregate Index Hedged (CAD)
U.S. Treasuries=Bloomberg Barclays US Treasury Bills; 1-3 Months CAD Hedged
Canadian bonds-FTSE Canada Universe Bond Index
U.S. corporate credit=Bloomberg Barclays US Corporate Investment Grade Hedged (CAD)
Global Real Estate=FTSE EPRA NAREIT Developed Real Estate Index NET
Global Infrastructure=S&P Global Infrastructure Index
Emerging Markets Debt=JP Morgan EMBI Global Diversified Index Hedged (CAD)
High Yield Bonds=ICE BofAML Global High Yield 2% Constrained Index Hedged (CAD)

funds for one-time purchases (such as a trip), and keep enough left over as an inheritance for their children or a charitable organization.

Focusing on high-yielding investments may not be the right approach. Yields derived from dividends and interest provide a variable income stream, rather than the stable monthly cash flow most retirees require. And if market fluctuations cause the yield to fall, the retiree may have to choose between current needs and estate goals. Moreover, higher-yielding investments can have unintended long-term risks, which could jeopardize the portfolio's total value, as shown in Exhibit 1.

We believe a better approach would be to thoughtfully combine a broad range of equity, real assets and fixed-income securities that have both income and growth potential.

Diversify across multiple sources of income

Diversification is the centerpiece of most investment strategies. The idea is for some assets to go up when others go down, thereby smoothing out returns. In an income-producing portfolio, diversification can be accomplished by owning bonds and fixed-income funds of varying credit quality and maturities, as well as including dividend-paying stocks and funds, municipal and corporate bonds and federal government bonds or Treasuries, certificates of deposit and money-market funds.

Diversifying outside the North American market can also give investors access to sectors and corporations that are expected to benefit from demographic trends, such as the growth of the middle class in emerging markets. And financial engineering has created a variety of hybrid products—such as structured credit—that further diversifies the kinds of fixed-income instruments available to the average investor.

The lower correlation of these investments to traditional asset classes that may also be in the portfolio can improve total portfolio diversification, potentially lowering overall risk.

Beware the risks of overeaching for yield

Higher-yielding bonds and equities have historically come with greater risk. Investors who prioritize short-term income over long-term growth in order to obtain higher yield may face unintended risks, particularly in today's low interest rate and return environment.

As Exhibit 2 shows, asset classes that provide a high current yield may be susceptible to far greater drawdowns in volatile markets.

Adapt the portfolio to risks and opportunities in the market

Investors should look for absolute return strategies that aim for more consistent returns, regardless of the direction markets take.

These strategies can combine a broad mix of income-producing and growth securities—ranging across many sectors and geographies—and dynamically move between those different assets depending on the opportunities presented by the markets. They usually don't try to match a benchmark as their goal is to provide a targeted return in all market conditions.

Investors should bear in mind that yield is only half of the total return equation. The price movements of fixed-income securities can impact bottom-line performance. We believe that active managers who take a holistic approach to generating returns can better help investors build a portfolio that provides sustainable income over their retirement horizon.

INVESTOR is published quarterly by Russell Investments.
Please direct comments or questions to your financial advisor.

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Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth.

As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns. Rebalancing your portfolio may create tax consequences on the taxable portion.

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Date of first publication: July 2019

RETAIL-02551