Starlight Capital
FOCUSED INVESTING

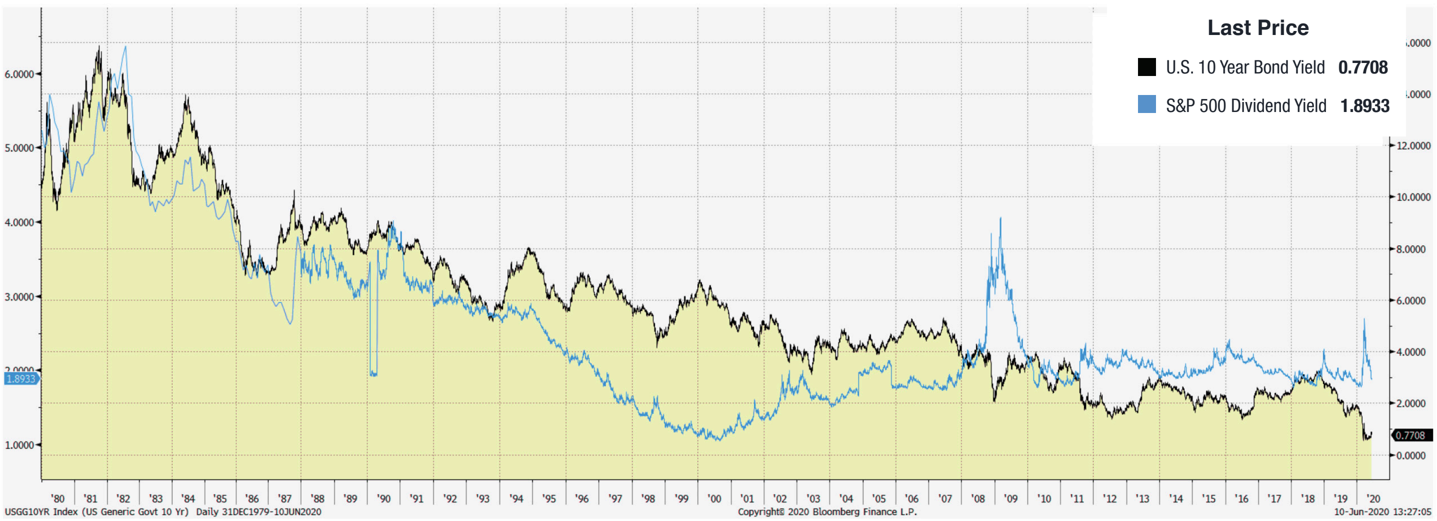
Real Assets and **Real Income**

The need for income continues to grow at a time when global bond yields are near historical lows and many global companies are cutting or suspending their dividends. In this environment, real assets stand out as a source of regular and growing, tax-efficient income for investors. The total return outlook for real assets should see them continue to attract capital from investors.

Real assets, specifically real estate and infrastructure, are businesses that provide essential services that allow global economies to function. These services include housing, healthcare, cargo transportation and distribution, communications, payment processing, data storage, electricity, water, waste collection and high-speed internet. Because of the essential nature of these services households, corporations and municipalities continue to pay for them, even during times of economic weakness. Many of these revenues are contractual in nature, providing even greater visibility and predictability of annual revenues and cash flows.

Historically, investors have looked at equities as risky assets designed to generate long term capital appreciation and bonds were seen as safer investments designed to provide stable income. The long-term trends show these characteristics reversing course as the U.S. 10-year bond yield peaked in 1981 at over 15.0% and has marched steadily lower since then. In contrast, dividend yields troughed in the late 1990’s at just over 1% and moved above bond yields during the Global Financial Crisis in 2008.

U.S. 10 Year Bond Yield vs. S&P 500 Dividend Yield



Source: Bloomberg LLP. As at June 10, 2020.

20 years ago investors could generate a comfortable 6.8% annualized yield by investing in AAA-rated 10 year U.S. government bonds. Today, to generate a similar income stream out of fixed income, investors are faced with two choices:

- Take on significantly more risk by investing in high yield or emerging market bonds; or
- Allocate significantly more capital to treasuries

Allocating to riskier companies or geographies during a time of global recession, pandemic and social unrest seems like a poor decision. Allocating more capital to treasuries is feasible but in order to generate the same level of income as offered 20 years ago, investors would have to allocate over 10x as much capital.

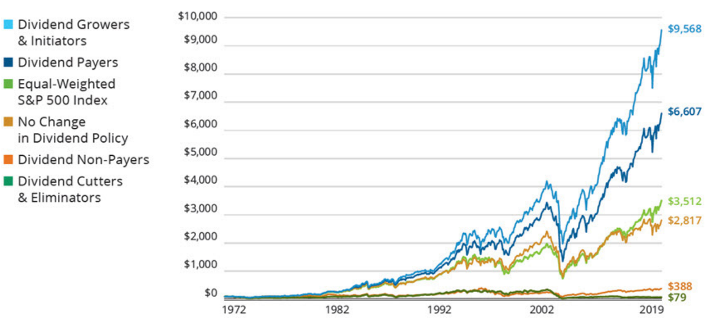
Required Capital to Generate Income

U.S. Treasury Income Analysis			
	2000	2020	2020
Capital	$100,000	$100,000	$1,041,986
Interest Rate	6.8%	0.7%	0.7%
Annual Income	**$6,800**	**$653**	**$6,800**

Source: Bloomberg LLP, U.S. 10 year yield as of January 20, 2000 and May 29, 2020.

Companies generally pay dividends out of earnings or cash flows. As those earnings and cash flows grow, firms are able to pay shareholders rising dividends. Historically, companies that have paid rising dividends (or initiated dividends) have outperformed companies that pay a static dividend and have dramatically outperformed the S&P 500.

Returns of S&P 500 Index Stocks by Dividend Policy: Growth of $100



Source: Ned Davis Research, February 2020.

The shares of companies that initiate or pay rising dividends have not just outperformed other equities, they have also done so with less volatility.

Average Annual Returns and Volatility by Dividend Policy

March 31, 1972 through December 31, 2019

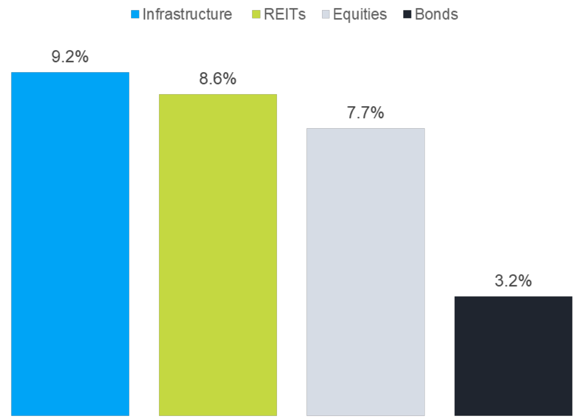
	Returns	Beta	Standard Deviation
Dividend Growers & Initiators	12.87%	0.92	15.61%
Dividend Payers	12.79%	0.98	16.36%
No Change in Dividend Policy	11.85%	1.13	17.92%
Dividend Non-Payers	8.57%	1.13	24.33%
Dividend Cutters & Eliminators	10.88%	1.23	24.08%
Equal-Weighted S&P 500 Index	12.29%	1.00	16.98%

Source: Ned Davis Research. Dividend policies shown are for stocks in the S&P 500 Index.

The COVID-19 pandemic has forced many businesses to cease or curtail activities, resulting in declines in revenues, earnings and cash flows. Several strategists have suggested that global corporate earnings could fall by as much as 30%, with dividends falling in lockstep. As of May 31, 2020, 56 S&P 500 companies have suspended or cut their dividends, demonstrating the long term impact of COVID-19 on their operations. In this environment, the demand for dividend paying stocks and the premium investors are willing to pay for companies that pay rising dividends should increase. Real assets that provide tax-efficient monthly income will continue to attract more capital from investors just as global institutions continue to allocate capital to private real assets.

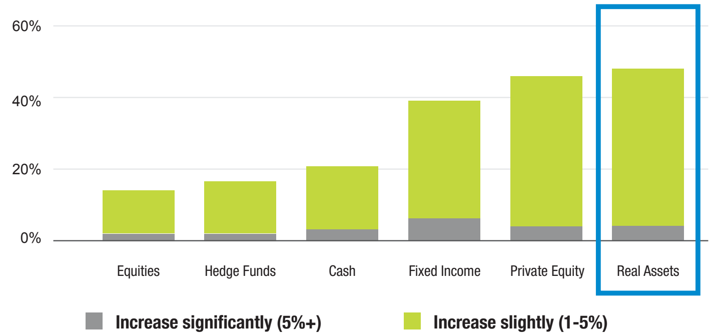
Over the last 18 years, real assets have consistently outperformed global equities and global bonds. A large portion of the total returns real assets have generated has been the dividends paid to investors. With equities trading at historically high multiples and global growth projections curtailed by COVID-19, the current environment continues to be favourable for real assets—low interest rates, low inflation, low growth and a growing demand for tax-efficient income. Large institutions have already significantly increased their allocations to real assets and will likely continue to do so in this environment.

Global Asset Class Total Returns



Source: Bloomberg from Dec 31, 2002 to Feb 28, 2020. Global Infrastructure, Global REITs, Global Equities and Global Bonds are represented by the S&P Global Infrastructure Index (CAD), FTSE EPRA/NAREIT Developed Total Return Index (CAD), MSCI World Index (CAD) and FTSE World Broad Investment-Grade Bond Index (WorldBIG) (CAD), respectively. Past performance is no guarantee of future results.

Allocation Outlook Real Assets Lead BlackRock's 2019 Annual Institutional Rebalancing Survey



Source: BlackRock, as at December 2018. Net percentages represent a net percentage intending to increase or decrease allocations to each asset class. (Calculation: % of firms intending to increase - % of firms intending to decrease) Base sizes: Total (230); Equities (225); Fixed Income (230); Hedge Funds (133); Private Equity (188); Real Estate (203); Real Assets (173); Cash (223). For illustrative purposes only. The figures/ net change represented in percentages are illustrative in nature and do not express a forecast. This information is not intended as a recommendation to invest in any particular asset class or strategy or as a promise of future performance. No analysis of their suitability was conducted and no statement of opinion in relation to their suitability is provided.

"We seem to be in a new phase with global rates in the range of –2% to +2% for the next five to seven years…We think that institutional investors will continue a push towards 60% alternatives allocation in their portfolios—from a global estimate of 25% today."

Bruce Flatt, CEO, Brookfield Asset Management Inc., Q3 2019 Letter to Shareholders

In 2019, the Starlight Global Infrastructure Fund (SCGI) experienced 33 dividend and distribution increases with an average increase of 9.5%. The fund was launched with a 5% annual yield paid monthly and in 2019, 81% of the distribution was treated as return of capital for tax purposes, making the distributions very tax efficient for investors. As of May 31, 2020, year to date the fund has experienced 15 dividend and distribution increases with an average increase of 6.7%.

In 2019, the Starlight Global Real Estate Fund (SCGR) experienced 30 dividend and distribution increases with an average increase of 6.4%. In addition, two holdings initiated dividends during the year. The fund was launched with a 5% annual yield paid monthly and in 2019, 87% of the distribution was treated as return of capital for tax purposes, making the distributions very tax efficient for investors. As of May 31, 2020, year to date the fund has experienced 12 dividend and distribution increases with an average increase of 8.0%.

After-Tax Yield Comparison					
	High Yield Bonds	Common Equity	Preferred Equity	SCGR	SCGI
Yield	7.55%	3.46%	6.81%	5.67%	5.21%
Tax Rate	53.53%	39.34%	39.34%	6.23%	7.54%
After-Tax Yield Comparison	**3.51%**	**2.10%**	**4.13%**	**5.32%**	**4.82%**
$100,000 Investment Example					
Capital	$100,000	$100,000	$100,000	$100,000	$100,000
Income	$7,554	$3,460	$6,810	$5,670	$5,210
Taxes Payable	**$4,044**	**$1,361**	**$2,679**	**$353**	**$393**
After-Tax Income	**$3,510**	**$2,099**	**$4,131**	**$5,317**	**$4,817**

Source: Bloomberg, E&Y Tax Calculators, Company Reports, Starlight Capital
Notes: High Yield Bonds represented by the Horizons Active High Yield Bond ETF, Common Equity represented by the S&P/TSX Composite Index, Preferred Equity represented by BMO Laddered Preferred Share Index ETF, SCGR is the Starlight Global Real Estate Fund series F, SCGI is the Starlight Global Infrastructure Fund series F. All yields and pricing as of May 31, 2020. SCGR and SCGI tax breakdowns as of 2019.

Learn more at starlightcapital.com or speak to your advisor.

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