

# Build your own global income fund

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Nearly all of us who are either members of a pension scheme, or who hold indirect investments through unit trusts, have attained a degree of exposure to foreign equity markets, but it's surprising how rapidly UK investors are embracing the idea of holding foreign-registered shares directly. According to Stéphanie Heng of Euroclear, the world's largest settlements house, the number of international securities in the Crest system (represented as CREST Depository Interests) has risen nearly sevenfold since August 2002, and is now worth in the region of £14bn. And I would wager that the number is on the rise amongst UK income investors hoping to compensate for yield shortfalls in the wake of the banking crisis and BP's Deepwater dividend disaster.

BP will resume dividends some day. But banks may never pay out at the same level they once did. Business Secretary, Vince Cable, recently took another shot across the bows of the banking sector, when he reiterated the coalition's determination to not only curb the worst excesses of the industry's bonus culture, but to also effectively limit distribution levels - even for those banks that haven't had to rely on public support. Banks are also under pressure to set aside a greater proportion of their profits in line with beefed-up Basel liquidity regulations, so it's probable that distribution rates from what was a previously reliable UK sector will not return to pre-crisis levels for some time to come (if at all).

Strip out half the UK's banking sector and the 12 per cent of gross distribution attributable to BP and you're left with a bit of a problem; FTSE100 companies currently yield 3.36 per cent, down from 4.38 per cent pre-Lehman, which serves to illustrate just how concentrated the UK's dividend pool has become. If you had to rely solely on UK stocks to fund the income component of your portfolio, then, by definition, your portfolio would be unduly exposed through an inadequate level of diversification. Of course, it's easy enough to remedy this simply through buying units in one of a rapidly growing number of 'global income' funds.

This one-stop approach has obvious attractions but consider the following statistic: only 2.6 per cent of the funds within the Global Growth category are yielding more than a single percentage point over the FTSE100 and you will be charged anything between 1.18 and 1.72 per cent annually to secure this paltry level of outperformance. That doesn't sound much, but the relentless arithmetic of compound interest means they could reduce your profit by up to a third over a decade.

Of course, construct your own portfolio and you will have to factor in dealing costs, but as the value of your investments rises, these will become less significant. More bothersome might well be costs and complications associated with receiving overseas dividends, plus the inevitable foreign-exchange risk.

The following table details 20 foreign-domiciled companies that would be worth considering if you're thinking of tapping into overseas revenue streams. All offer established patterns of income distribution, together with adequate cover and sustainable net debt positions. The companies have been chosen with income in mind, but balance sheet stability has been taken into account. Some emerging markets have been ruled out because of issues surrounding liquidity, market transparency and corporate governance.

With economic uncertainties very much to the fore, two defensives make the list in the form of US tobacco giants Altria Group (formerly Phillip Morris) and Reynolds American. Both companies are currently yielding in excess of six per cent and their revenue streams aren't adversely affected by

cyclical factors. Liquor and tobacco stocks are usually characterised by slow and steady growth, high returns on capital and solid dividend payouts. Just the ticket when you're chasing income. In relative terms there are fewer companies from the world's emerging markets that follow a defined dividend policy, but we have included Taiwan-registered MediaTek – the second largest global semiconductor producer in the field of mobile phone chipsets – as the type of growth company with high rates of return that can provide both significant income, whilst still producing capital growth for your portfolio.

We didn't consider a number of European banks because of the uncertainties surrounding sovereign debt issues, but exceptions were made in the cases of Nordea Bank AB and DnB NOR - two of the Nordic region's largest lenders. Nordic banks have had their own problems of late as a result of non-performing loans in the Baltic States, but impairments have not been as bad as initially feared, and are now in decline. Nordea Bank AB and DnB NOR have managed to avoid the worst of the credit crisis because they tend to generate most of their revenue from regional retail banking and have few risks tied to capital market activities. The last point is significant in terms of income distribution because under the Basel 3 reforms the most intensive capital requirements are reserved for those banks with significant securitisation exposure. Banks operating within a predominantly retail structure should therefore be in a better position to reward shareholders.

## 20 Global Income Plays

Name (ticker)	Identifier	Price (1Y %)	Price (5Y %)	P/E	Yield (%)	Cover	Debt/EBITDA	Beta
Altria Group	NYSE: MO	26.5	43.1	13.3	6.35	4.74	1.88	0.33
AT&T	NYSE:T	1.6	7.6	13	6.42	4.79	1.67	0.69
Banco do Brasil	SAO:BBAS3	23.2	191	6.7	6.01	11.42	na	1.26
Bank of Nova Scotia	TSX: BNS	11	20.8	14.1	3.83	7.43	9.4%*	0.75
BASF	GER:BASF	36.9	62	20.6	3.68	1.32	1.26	1.3
Commonwealth Bank	ASX: CBA	29.6	32.9	15.8	4.51	2.75	8.1%*	0.69
DnB NOR	OSL:DNBNOR	39.5	17.4	10.3	2.32	4.2	8.2%*	0.95
Endesa	MCE:ELE	3	29.5	4.5	5.41	9.84	2.2	0.88
Enterprise Products	NYSE: EPD	29.5	38.4	20.9	6.01	3.45	3.7	0.53
Fortum	HEX: FUM1V	6.4	20.4	10.6	5.7	1.65	2.8	1.02
KPN	AEX:KPN	10	55.2	7.8	6.2	3.09	2.4	0.32
MediaTek	TAI: 2454	7.3	98.7	12.8	5.38	2.69	na	0.98
Mobile TeleSystems	NYSE:MBT	33.6	18.7	14.5	6.33	0.84	1.1	1.56
Nordea Bank	STO:NDESEK	7.8	23.4	12.3	3.37	2.44	9.3%*	1.31
Reynolds American	NYSE:RAI	37.3	39.7	16.3	6.2	3.96	1.1	0.58
Rogers Communications	TSX: RCI.B	18.9	61.9	15.5	3.48	8.5	2.1	0.65
Royal Bank of Canada	TSX: RY	4.7	34.9	13.9	3.75	7.68	9.7%*	0.65
Telefonica	MCE:TEF)	-2	23.3	9.9	6.81	3.23	2.4	0.53
Westpac Banking	ASX:WBC	17.2	20.1	13.8	5.4	2.65	8.1%*	0.75
Woolworths	ASX:WOW	-1.5	57.5	15.6	4.22	3.13	0.5	0.41

\*Core tier one capital ratio

SOURCE: Thomson Reuters & Capital IQ

*The company identifiers are those used on the FT.com website. Other data suppliers may present identifiers differently, or use different identifiers*

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## Withholding tax & execution charges

Although, you don't have to pay UK Stamp Duty or Stamp Duty Reserve Tax if you buy foreign shares, if you receive investment income from abroad, you'll usually need to declare this on a self-assessment tax return. If you find you have been charged tax both in the country of origin and in the UK, you may be able to claim foreign tax credit relief. As far as dividends are concerned, the UK has signed many double-taxation agreements with other countries, which usually set out a maximum rate of tax that a given country can charge on payments to UK residents. These agreements also determine that credit is given for taxes paid in one country against taxes paid on the same income in the other country.

This withholding tax – so named because the taxable component is withheld by the governing revenue agency – can be claimed back through the self-assessment form, although the amount is restricted to the pre-agreed levels between the UK Treasury and their overseas counterparts. Unfortunately, it is not unknown for some foreign tax authorities to charge withholding tax at a rate above the pre-agreed maximum. A way around this is for UK investors, or their nominees charged with processing their dividends, to simply register with the relevant tax authority. It is estimated that as much as one-quarter of withholding tax goes unreclaimed by UK investors every year, so it makes sense to clarify your tax position prior to investing in overseas securities.

Stockbrokers offer both advisory and discretionary services to their clients, but if you are confident in your stock selection, then execution-only services for investors have become gradually cheaper for investors since 2001. TD Waterhouse, for instance, offers a flat per trade fee of £12.50 for international deals, which reduces to £9.50 if you make more than 10 trades in a quarter. The company has direct access to companies trading on 16 international bourses. The company also enables investors to nestle their overseas investments in an Isa with the same tax-free allowance.