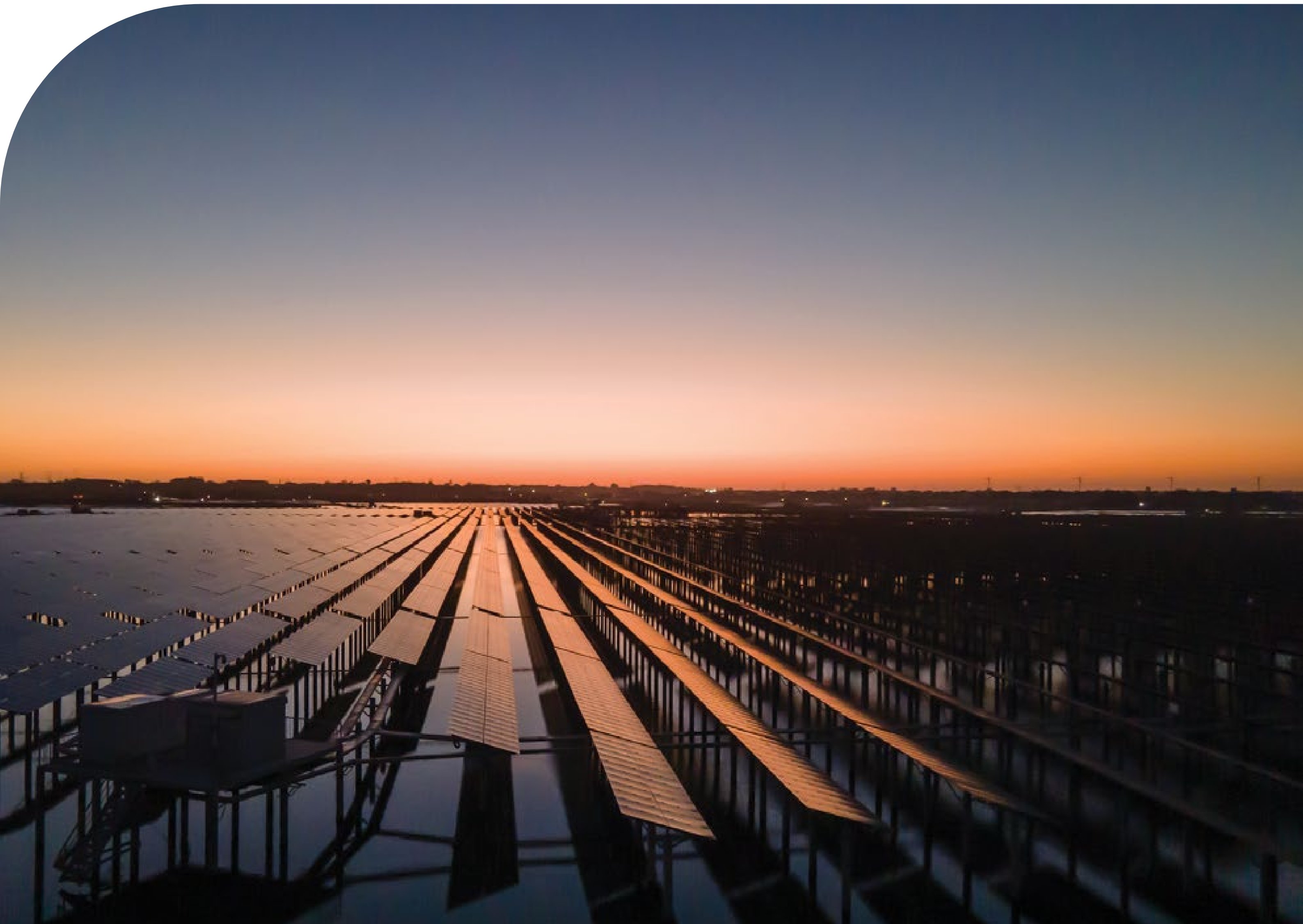
STRATEGY GUIDE

Martin Currie Australia Sustainable Income

MARTIN CURRIE
A Franklin Templeton Company

JANUARY 2025

COMBINING SUSTAINABILITY AND CLIENT ETHICAL VALUES WITH A 'SUFFICIENT INCOME FOR LIFE'



INVESTING TO IMPROVE LIVES™

www.martincurrie.com/australia

Combining sustainability and client ethical values with a 'sufficient income for life'

The **Martin Currie Australia (MCA) Sustainable Income** strategy invests in a diversified portfolio of ethically screened ASX-listed equities.

We aim to meet the income needs of investors by providing a consistent and growing income stream through an actively managed selection of high-quality companies, favouring those that are highly franked dividend payers, and those which have been assessed using a proprietary approach for understanding sustainability and financial attributes.

This approach results in a portfolio distinct from traditional equity portfolios and sustainability-focused strategies.

Key Pillars of the Strategy

Proprietary multi-lensed research by an experienced team

The MCA team has over 40 years of experience investing in Australian equities and listed Real Assets using a disciplined and repeatable multi-lensed investment approach.

A 'sufficient income for life' focus

Our unique approach aligns with the income needs of retirees, targeting a high and stable franked dollar income stream, income growth, capital growth and diversification.

A unique approach to Sustainability assessments

We seek companies that provide more benefit than harm to society, have a management that focuses on their sustainability risks, and have a clearly articulated pathway towards a sustainable environmental, social & economic future.

No binary choice between sustainability, ethics and returns

The inclusion of ethical values and ESG exclusions based on client-specific requirements is complementary to our focus on high-quality, dividend paying companies for income.

Optimised portfolio construction for income-focused returns

Our benchmark unaware portfolio is constructed to minimise concentration risks, income shocks and capital impairment.

Fully integrated fundamental Active Ownership approach

Responsibility for Active Ownership lies directly with the research analysts and portfolio managers responsible for making investment decisions.

Key Benefits of the Strategy

The potential for an attractive and growing income stream

Investing in higher quality companies (as determined by MCA's proprietary analysis) that support higher dividend payments over time, resulting in potentially higher income compared to more defensive strategies.

Highly franked income

Franking provides a differentiated source of return, allowing more of the total return to come from a stable source. The portfolio is managed to maximise the benefits from franking credits for investors with low or zero marginal tax rates.

Greater income certainty

Diversified portfolio construction reduces income concentration risks, ensuring a more predictable income stream regardless of economic cycles or capital movements of a stock.

Lower total volatility

Income-focused investments typically exhibit lower total volatility compared to broader equity markets or sector-specific strategies, providing stability to income-focused portfolios.

Sustainability driven portfolio construction

The positive tilt towards companies with more favourable proprietary **Sustainability** and **Shadow Carbon Cost** assessment results in a portfolio with a lower carbon footprint and more attractive **Sustainability** attributes relative to the market.

Who the strategy is suited to

The strategy is relevant for investors looking for:

- an active approach to investing, with a focus on income generation;
- the benefit of franking credits at low or zero marginal tax rates;
- negative screens that Incorporate client-driven ethical values and beliefs;
- positive screens that facilitate better outcomes for both stakeholders and for investors; and
- a diversifying portfolio compared with other equity investments.

We believe that our long-term track record in income generation through varied market cycles demonstrates our ability to deliver stable and dependable returns to investors seeking income-oriented strategies.

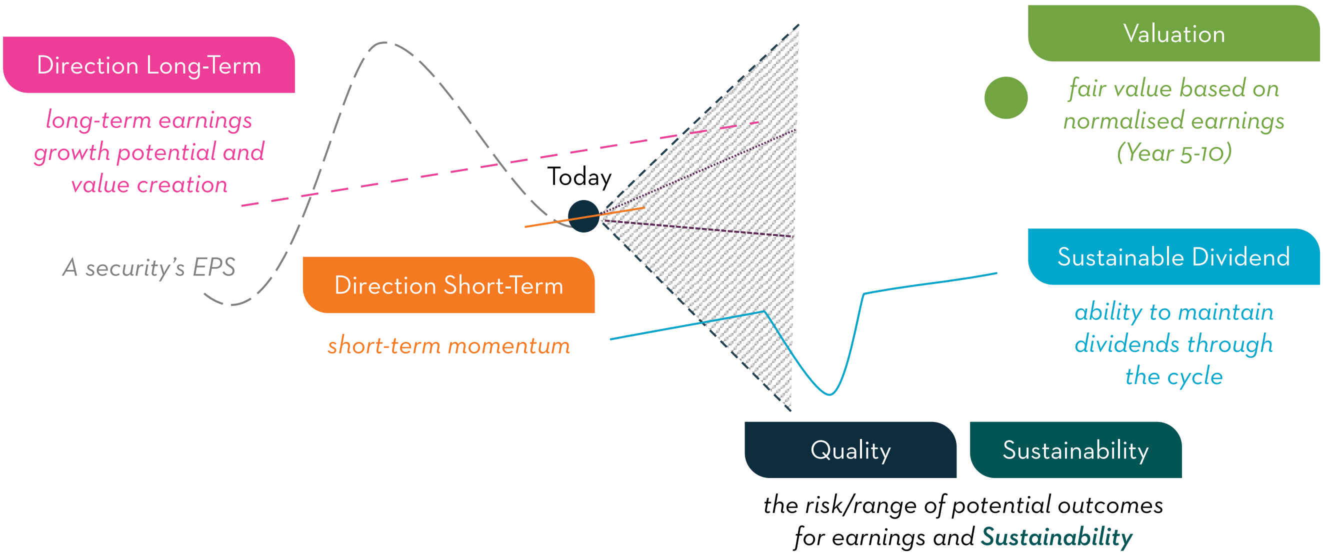
How we identify opportunities

Proprietary multi-lensed research by an experienced team

The MCA investment platform offers full access to the multi-lensed fundamental insights and Active Ownership activities of a highly experienced research team. Our disciplined portfolio construction process can be fully customised to provide strong alpha potential across a range of Australian equity and listed Real Asset solutions. We believe our forward-looking fundamental insights are the key to investment success, however we also recognise how our quantitative risk flags can incorporate a broad set of incremental information in a timely and balanced manner.

The investment process for all MCA strategies, including **MCA Sustainable Income**, starts with bottom-up fundamental research by our specialised industry analysts. The size, quality, and experience of our investment team underpin our proprietary research efforts into long-term normalised earnings power, cashflow sustainability, business quality, and risk of listed equities.

Our approach recognises the importance of multiple drivers in generating returns. We have designed our framework to capture forward-looking fundamental and qualitative insights across our **Valuation**, **Quality**, **Direction Short-Term**, **Direction Long-Term** and **Sustainable Dividend** research lenses. **Sustainability** is a key component of our **Quality** research lens.



Past performance is not a guide to future returns.

Source: Martin Currie Australia; data shown for illustrative purposes only.

This multi-lensed framework allows our analysts to detail their independent insights in a step-by-step and consistent manner. It creates a common language for expressing our views on the risks and opportunities for each company across the investment universe, fostering an environment of team ownership and ongoing improvement.

A 'sufficient income for life' focus

The traditional view of investing suggests that retirees should move away from growth-style assets and towards defensive assets due to increased risk aversion. We challenge this notion.

Retirees typically need a reliable income stream that grows with inflation to replace their wages. We believe there is a disconnect between this need and the typical defensive retirement portfolios based on total risk/total return theory. Instead of capital or total volatility as a standard risk measure, income stability is a better proxy for the risk of impaired living standards for retirees. This approach suggests a greater focus on growth assets in retirement portfolios.

We acknowledge that higher equity exposures can make investors uncomfortable. However, not all equities are created equal. The **MCA Sustainable Income** strategy is designed with the income needs of clients at its core, resulting in a portfolio distinct from both traditional equities and other income-focused approaches.

Our Sufficient Income for Life philosophy aims to achieve:

- A high and stable franked dollar income stream to support annual expenses
- Income growth for inflation protection
- Capital growth to manage longevity risk
- Diversified growth exposures to reduce income sequencing risk

Stocks that perform well in traditional equity accumulation funds may not always be suitable for income portfolios. We identify high **Quality** companies that can generate high free cash flows and resilient dividends that can match rising living costs. By avoiding stocks with unsustainable dividends, we aim to provide lower income volatility and more income certainty.

We also seek to identify stocks that maximise the benefits of franking credits to enhance after-tax income for low or zero marginal tax rate payers. Our Valuation process explicitly recognises the value of franking credits and actively selects companies with high franking rates and Sustainable Dividends, while penalising unfranked dividends and avoiding practices that lead to loss of franking credits.

Spotlight on our Sustainable Dividend research lens

When a company pays a very high dividend that cannot be sustained, and then ends up cutting it, it can create an income shock to the dollar income level of the portfolio as a whole. And if sold out automatically after the yield fell, it can also result in an impaired capital value despite maintaining a steady headline yield.

Sustainable free cash flow analysis is a natural component of our fundamental research approach, and **Sustainable Dividend** is our fundamental estimate of a company's ability to maintain payments to shareholders.

Analysts judge each company's dividend paying power by assessing free cash flow generation through different stages of the economic cycle and look through any financial engineering that may artificially boost headline or near-term dividends. They explicitly model a 'bear case' scenario, rather than the 'worst case' dividend, because that is always going to simply be zero for every company. The advantage of this approach is it allows us to consider a significant downside scenario for each company and what level of dividend they can pay in a crisis.

We also take into consideration debt levels and refinancing expectations, potential business threats to dividends, and sustainable levels of franking based on tax domicile, geographic mix and capital structuring. Our downside scenario analysis includes higher interest rates and inflation; our process therefore has a strong preference for owning stocks that can deliver on our income growth objectives even in a rising interest rate environment.

Overall, Sustainable Dividend is a conservative estimate, generally below the current dividend and reflecting the free cash flow we forecast that a company is likely to generate near the bottom of the economic cycle.

Optimised portfolio construction for income-focused returns

When looking at portfolio construction though an income lens, we do not think it is appropriate to include any particular security in a portfolio just because it has a large weight in an arbitrary index. Stocks with low dividend pay-outs, higher volatility or lower quality may not align with income generation goals.

Rather than being built to satisfy traditional benchmark-relative alpha targets or tracking error measures, the portfolio is highly diversified to minimise income concentration risks and income shocks. This ensures that portfolio total yield is not dominated by any one security, or impacted by an income shock in any one high index weight stock.

Due to the concentrated nature of the Australian market, typically Australian benchmarks are also not a very good mirror of the effect that Australian inflation has on long-term income requirements. Therefore, we have structured our portfolios to have better diversification across the domestic economy, in sectors such as consumer, financials and real assets, and this means that they have income growth more correlated to income needs.

To improve capital growth, we also avoid the use of derivative strategies for income enhancement or the use of high turnover to harvest dividends.

Our unique approach to Sustainability assessments

Our investment approach reflects our belief that financial returns and ESG impacts are fundamentally intertwined, and that it is possible to generate both sustainable outcomes for stakeholders and long-term investment returns.

The following **Sustainability** assessments are undertaken for all stocks in our investment universe:

- Sustainability Risk: an assessment of common sustainability risk factors that we believe are faced by a company and its industry. This includes consideration of Biodiversity, Modern Slavery and other factors. Our proprietary Carbon Value at Risk (VaR) tool is also used to consider **Shadow Carbon Cost** risk.
- Net Sustainability Benefits: an assessment of a company's overall impact on society. UN Sustainable Development Goals (SDG) mapping forms part of this assessment.
- Sustainability Pathway: an assessment as to whether material ESG factors are likely to improve for a company's operations, products, and services. We consider factors such gender representation on boards and First Nations outcomes, the momentum of change, and responsiveness to feedback.

Capturing the impact of carbon

We have developed a proprietary Carbon Value at Risk (VaR) tool to assess the sensitivity of each stock and the portfolio to climate transition risk.

Our tool looks at how a company's valuation could be impacted by applying a Shadow Carbon Cost, and this helps us to identify stocks that will either benefit or have a minimal impact on their earnings from the energy transition.

We base our assessments on a carbon cost assumption of A$80. The rationale is that this price is where there would be an economic incentive for energy companies to switch from coal to gas, and it is also similar to the EU Carbon Allowance EUA physical future (i.e., the most liquid market).

Importantly, our analysis takes Scope 1, 2 and 3 carbon emissions into consideration. Scope 1 and 2 emissions can be mitigated by investment in new technologies to replace and reduce existing assets that contain high carbon emissions, but it is Scope 3 emissions which capture downstream value-chain activities, which we believe better reflect a company's strategic risk with regards to carbon. Our model supports the purchase of carbon offsets to reduce the net emissions when no viable alternatives exist.

Shadow carbon cost assessment

- **Based on Scope 1, 2 and 3 carbon emissions**
- **Carbon cost of A$80/t CO_2-e**
- **Evaluation of transition path towards a low carbon world**
- **Ability of a company to pass carbon costs through to customers**

No binary choice between sustainability, ethics and returns

Investors don't want to have to choose between income, their values and sustainability – and we believe they shouldn't have to.

We have a long history of designing investment products that solve for a client's income needs. Following engagement with investors, institutional clients, financial advisers, and even our own retirement-age parents, we launched our first dedicated income strategy, Equity Income, in 2010. Since then, our income platform has evolved to include ethically-screened and sustainability-tilted offerings, Australian and Global Real Asset focused portfolios, and multi-asset income solutions.

The **MCA Sustainable Income** strategy was launched in December 2015, with the aim of providing investors – such as charities, foundations and not-for-profit organisations – with an ethically screened version of our high-quality, low-risk Australian Equity Income investment option. The process was enhanced in 2023 to include a positive tilt towards companies with more favourable proprietary **Sustainability** assessments for Sustainability Risk, Net Sustainability Benefits, Sustainability Pathway and **Shadow Carbon Cost**.

Through our experience, we have found that the inclusion of ethical values and ESG exclusions based on client-specific requirements is complementary to our focus on high-quality, dividend paying companies, and does not compromise the ability to meet income objectives. Due to our emphasis on **Quality** and **Sustainable Dividends**, very few stocks in our investment universe that pass the grade for our traditional Equity Income portfolios are excluded by the Ethical and ESG Impact screens of the strategy. This reflects our belief that our **Sufficient Income for Life** focus is already complementary to the income needs of a sustainability-focussed investor.

Ethical values and ESG exclusions

We actively screen out companies that do not meet the strategy's ethical investment criteria to ensure the portfolio does not invest in securities with excluded business activities. The screens consist of the following criteria:

- Companies with revenues related to any one of the following activities that represent more than 5% of the company's total revenue, or revenues from a combination of any of the following activities that represent more than 10% of the company's total revenue:
  - Alcohol
  - Adult entertainment
  - Tobacco
  - Fur
  - Gambling
  - Genetically modified crops
  - Nuclear power
- Companies with revenues related to any one of the following activities that represent more than 5% of the company's total revenue, or revenues from a combination of any of the following activities that represent more than 10% of the company's total revenue:
  - mining, extraction, refinement, transportation, distribution, and power generation
    - from thermal coal
    - from conventional & unconventional oil and gas
- Companies directly involved in:
  - the production of controversial weapons
  - the manufacture of tobacco products
- Companies that do not meet MCA's assessment of Modern Slavery (including child labour)
- Companies that, in the opinion of Martin Currie Australia are not operating in accordance with widely accepted international norms and principles, including the:
  - Universal Declaration of Human Rights
  - International Labour Organisation (ILO) Declaration on Fundamental Principles and Rights at Work
  - United Nations Global Compact
  - United Nations policy on trafficking in humans
  - the OECD Guidelines for Multinational Enterprises

See Product Disclosure Statement and associated reference documents for further clarification on our proprietary sustainable investment approach and exclusions.

Should an investment cease to be consistent with the screens imposed, such investment will be divested as soon as reasonably practicable and in the best interests of investors.

The criteria for determining our ethical screens has been drawn from working with third-party vendors, charities and foundations on their investment requirements. The criteria for the screens are expected to be static in nature; however, they can be adjusted over time to fit with market norms and market demand, and also client specific requirements.

Importantly, while the **MCA Sustainable Income strategy** incorporates these exclusionary screens, we also include positive consideration of ESG factors through our analyst's **Quality** and **Valuation** assessments.

Fully integrated fundamental Active Ownership approach

A cornerstone of our investment approach is Active Ownership, which includes comprehensive Environmental, Social, and Governance (ESG) integration, engagement with portfolio companies, and voting.

Active Ownership has been deeply embedded in our investment process since 2009, and reflects our belief that ESG factors can impact the risk of companies delivering the normalised earnings and dividends that our analysts forecast. Our **Sustainability** assessments feed into our **Quality** and **Valuation** lenses.

ESG factors underlie the growing pressures faced by all companies from their key stakeholders. Regulators, customers, suppliers, investors, local communities, employees and environmental groups all present companies with challenges and opportunities that ultimately have to be addressed by management. Companies that fail to address the needs of key stakeholders by managing these challenges effectively may face substantial reputational and financial damage in the future.

We see that these types of ESG factors can impact the normalised earnings that our analysts forecast in our **Valuation** lens, and therefore the long-term intrinsic value and potential long-term performance of a company. Where material to a company's ability to generate long-term returns, our analysts factor in the costs/benefits of ESG inaction or action directly into their normalised earnings (five years of earnings per share forecasts).

Quality for us is a key measure of risk, and we include our *Management*, *Governance* and **Sustainability** ratings directly in our overall assessment of **Quality** for each stock. This **Quality** rating is also used as a component in the stock-specific discount rates used for **Valuation**.

The MCA investment team uses **Quality** and **Valuation**, among other factors, to build conviction in securities and to set target position sizes across all portfolios. As a result, the combination of **Quality** and **Valuation** adjustments can tilt our assessment of fair value on these stocks, and ESG factors can directly impact the size of an individual security position in a portfolio, or our decision to invest in, or divest from these companies.

Unlike many quantitative-only and passive funds, responsibility for Active Ownership lies directly with research analysts and portfolio managers responsible for making investment decisions as we believe they are best positioned to develop an informed view of the ESG risks, opportunities, and impacts that companies face or create. Our investment team's long-term experience and strong relationships and open dialogues with boards and management teams allow them to express concerns and encourage greater transparency in how companies manage these risks.

Using engagement to influence companies to make positive change

Engagement is an important source of fundamental information that helps us improve our understanding and conviction in investee companies and their governance structures. It enables us to understand to what extent companies have identified material ESG risks and how they are managing these and also provides us with an opportunity to share best practice and help steer companies towards improved corporate practice. Our approach is to engage not only with the management of companies, but also with a range of other stakeholders for each business such as competitors, customers, suppliers and government agencies to develop a more rounded view of relevant ESG risks and opportunities.

Promoting stewardship through proxy voting

Proxy voting at AGMs is a core element of our approach to active ownership. We believe it is our job as fiduciaries to make a stand where we see an issue as critical to a stock's performance in the long term. Annual General Meeting (AGM) season (typically October to December in Australia) is a critical time for us as investors to re-emphasise our stance regarding a board's progress on ESG matters and we engage directly with companies on contentious proposals.

The Sustainable Income Portfolio

Experienced portfolio management

The **MCA Sustainable Income** strategy is co-managed by Reece Birtles, Chief Investment Officer & Portfolio Manager, and Will Baylis, Portfolio Manager. Reece has ultimate management responsibility for the strategy.

Reece Birtles
Chief Investment Officer
& Portfolio Manager

Will Baylis
Portfolio Manager

The strategy is supported by the broader MCA investment team through detailed fundamental research analysis across MCA's four research lenses for each company within the investment universe. In addition, our quantitative research function is continually looking for new ways to improve the investment process and the efficacy of our stock decisions and portfolio risk/return outcomes.

Fundamentally driven portfolio construction

Regardless of the strategy, our investment team's multi-lensed research provides the foundation for our portfolio construction process, with fundamental research outcomes feeding directly into our expected returns for each stock.

For each strategy, we calculate these expected returns in a customised manner by tilting towards inputs from the most relevant research lenses, thus aligning stock selection and portfolio construction with the specific objectives of each strategy. The resultant expected return is the difference between our Valuation post any strategy-specific **Quality/ Sustainability**, Direction Short-Term, Direction Long-Term and Sustainable Dividend adjustments and the stock's current market price.

For our **MCA Sustainable Income** strategy, we aim to build a high-quality portfolio that can provide investors with a growing income stream, incorporates client-driven ethical values and beliefs while facilitating better outcomes for both stakeholders and for investors. As such, we weight the calculation of our expected returns more towards Sustainable Dividend and the **Sustainability** component of **Quality** to a greater extent than in other strategies.

We also use benchmark-unaware disciplined portfolio construction rules to maximise a Sufficient Income for Life. We limit individual securities to a maximum 6% of the portfolio, meaning the portfolio's total yield is not dominated by any one security. We also limit the portfolio to a maximum of 25% in any one economic sector. These limits mean that the portfolio is structurally underweight the Top-20 ASX stocks, one of the most concentrated markets in the world. From a sector view, the index is dominated by banks and metals & mining sectors, which are typically volatile dividend payers. Our income strategies do not use derivatives, are fully active, and are designed to be low turnover.

Final stock selection is augmented by the Portfolio Manager's fundamental judgement, and takes into consideration the strategy's negative screens. The portfolio typically holds around 40 stocks.

Key facts

Launch date	December 2015
Performance objective	The strategy aims to provide an after-tax yield above the S&P/ASX 200 Index yield and to provide an income stream growth above inflation
Benchmark	No formal benchmark
Investable universe	Australian listed securities/all-cap
Number of securities	Typically 40
Security limits	Absolute 6%
Sector limits	Absolute 25%
Portfolio turnover	Typically 25% p.a.
Tracking error	We do not target tracking error, but total risk outcome is typically 90% of the market
How to access	Segregated mandate Martin Currie Sustainable Income Fund (An Australian Unit Trust) • APIR: SSB4946AU Also available as an SMA

Investment vehicles only available in certain jurisdictions. The characteristics shown are guidelines only and are not hard risks limits.

About Martin Currie Australia

Specialist investment manager of **Franklin Resources Inc.**

40+ years in **Australian equities**

World class **ESG credentials***

Tailored investment options aligned to client needs

17 member team of **specialist investment analysts**

A$6 billion in **Australian equities**

Source Martin Currie Australia; as of 31 December 2024.

*For further information on our ESG credentials please refer to full details on our website: *www.martincurrie.com/our-story/our-stewardship-approach*

Important information

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Past performance is not a guide to future returns.

The distribution of specific products is restricted in certain jurisdictions, investors should be aware of these restrictions before requesting further specific information.

The views expressed are opinions of the portfolio managers as of the date of this document and are subject to change based on market and other conditions and may differ from other portfolio managers or of the firm as a whole. These opinions are not intended to be a forecast of future events, research, a guarantee of future results or investment advice.

The information provided should not be considered a recommendation to purchase or sell any particular strategy / fund / security. It should not be assumed that any of the securities discussed here were or will prove to be profitable.

It is not known whether the stocks mentioned will feature in any future portfolios managed by MCA. Any stock examples will represent a small part of a portfolio and are used purely to demonstrate our investment style.

The analysis of Environmental, Social and Governance (ESG) factors forms an important part of the investment process and helps inform investment decisions. The strategy/ies do not necessarily target particular sustainability outcomes.

Risk warnings - Investors should also be aware of the following risk factors which may be applicable to the strategy shown in this document.

- Investing in foreign markets introduces a risk where adverse movements in currency exchange rates could result in a decrease in the value of your investment.
- This strategy may hold a limited number of investments. If one of these investments falls in value this can have a greater impact on the strategy's value than if it held a larger number of investments.
- Smaller companies may be riskier and their shares may be less liquid than larger companies, meaning that their share price may be more volatile.
- Income strategy charges are deducted from capital. Because of this, the level of income may be higher but the growth potential of the capital value of the investment may be reduced.

Franklin Templeton Australia Limited as Responsible Entity has appointed Martin Currie Australia as the fund manager for Martin Currie Sustainable Income Fund (ARSN 618 906 068, APIR SSB4946AU)

Please read the relevant Product Disclosure Statements (PDSs) and any associated reference documents before making an investment decision. In accordance with the Design and Distribution Obligations and Product Interventions Powers requirements we maintain Target Market Determinations (TMD) for each of our Funds. All documents can be found via www.franklintempleton.com.au or by calling 1800 673 776.

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