WEBB ASSET MANAGEMENT

November, 2010

Monthly Commentary

SYSTEMATIC, PROVEN & RELIABLE

Commentary

A ‘Real’ Income Fund

Call me old fashion, but I think a ‘real’ income fund should pay its distributions from income earned by the fund and not from liquidating the fund’s securities. A fund’s payout ratio should not be > or = 100%. An income fund should produce consistent internal cash flow to pay the distributions to unit holders, plus the costs of running the fund, plus a cushion left over for rainy days.

The policy of an income fund should be no different than the policies followed by dividend paying companies. Dividend paying companies such as the Canadian banks or telecoms generally have payout ratios < 50%. Companies generally keep the payout ratios below 50%: 1) to keep some cash flow to grow the business, and 2) so the distribution does not need to be cut if there is a downturn in their business.

If you look at most Canadian income funds you will notice that these funds do not follow this policy. Almost all income funds have distributions greater than the funds’ internal yield minus the costs of running the fund. These are not income funds, they are return of capital funds.

This is analogous to investing in an apartment building that has a stated annual distribution. However, to pay that distribution management must sell a few apartments each year. In future years there will be fewer apartments you actually own in the building and therefore lower cash flow. Ultimately, you might not own any of the building. This is not a sound long-term investment strategy.

The Webb Enhanced Income Fund’s stated goals are as follows: 1) generate cash income each month that adequately covers: the distribution, the fund expenses, and leaves cash left over to be reinvested back into the fund, 2) grow the NAV of the fund net of the distribution at a rate above inflation, and 3) shelter the monthly distribution and the annual excess cash flow from taxes.

The Webb Enhanced Income Fund is structured like a conservative dividend paying company. The fund generates substantially more net cash than it pays out to unit holders. The excess cash is reinvested back into the fund which helps further grow the NAV and in turn grow future cash distributions. Given the tax wrapper on the fund, the fund is more attractive than investing in a good dividend paying company, as there are no taxes on: the distributions, the excess cash flow paid back into the fund, or the capital gains on securities sold in the fund. In many ways the fund’s structure is superior to an RSP.

Since inception, the Webb Enhanced Income Fund has had an average distribution to unit holders of over 8% annually. In addition to the 8% distribution yield, the fund has generated an additional excess 11% annual cash flow yield which has been reinvested into the fund. Simply stated the fund has had an 11% annual internal growth rate after paying an 8% annual distribution. This is very impressive for any dividend paying investment.

- Derek Webb

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