ETFS Investment Research

ETF Securities | The intelligent alternative | August 2019

etf Securities

Investing in ETFs over Reporting Season

Key Points: ETFS S&P/ASX 300 High Yield Plus ETF

- August reporting season is in full-swing, presenting investors with both opportunities and risks.
- ETFs offer a simple and cost-effective way to diversify away from single name risks.
- **ZYAU**, which holds companies based on quality and yield factors, could be an attractive solution over this period.

Reporting season is upon us as most Australian companies prepare to present their financial results for the period ended 30 June 2019. This article looks at the risks and opportunities that may present themselves during the up-coming weeks and demonstrates how ETFs can be used to avoid some of the pitfalls that can arise.

Reporting Season highlights

Of the S&P/ASX 200 constituents, 152 will report by the end of this month, with activity peaking in the middle two-weeks of August.

Highlights include Rio Tinto on 1st of August, Commonwealth Bank on the 7th, CSL Limited on 14th, Telstra Corp on the 15th and BHP Group on 20th. Wesfarmers and Woolworths report on 27th and 29th, respectively. Figure 1 provides a visual guide to the season ahead.

Figure 1: Number of S&P ASX 200 companies reporting each day during August. (Not all company logos are included)
Source: Bloomberg. Data as at 1 August 2019.

Opportunity or Risk?

Over the coming weeks market professionals will be positioning their portfolios and adjusting their ratings and targets in anticipation of earnings reports. Not only are they forecasting company results, following each announcement comes the task of digesting the details and evaluating how the market will react.

With China's slowing economy, global trade concerns, Brexit, Hong Kong and rate cuts on the cards both locally and abroad, there are also a lot of external factors to consider.

For professional investors, reporting season represents an opportunity. Those with better insight into the workings of each company and a better ability to read how the market will interpret earnings reports and changes in external variables have a better chance of beating the market.

For average investors, however, the risks of making a bad call on a single company can often outweigh the potential rewards.

Stock Picking Is a Zero-Sum Game

It is often not appreciated that stock picking and active management is a zero-sum game. For every investor who outperforms the market, another investor must underperform. The average return earned by all investors is, by definition, the return of the market.

To demonstrate this, we introduce the concept of *dispersion*. Dispersion is a measure of how spread out stock returns are over a period of time. Figure 2 shows two simple examples.

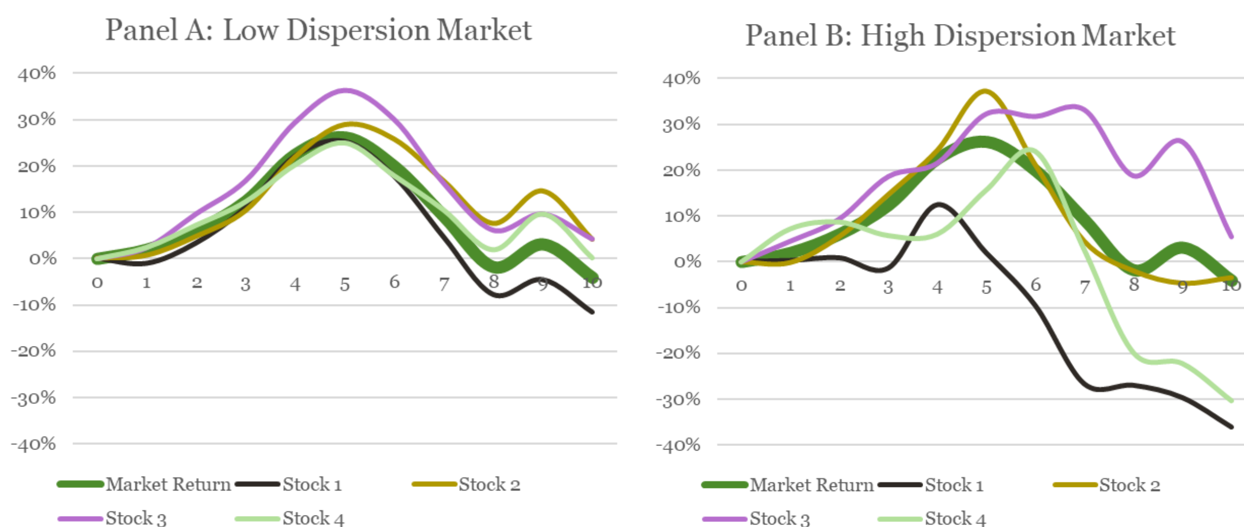

Figure 2: Sample high and low dispersion charts

In Panel A, where dispersion is low, the opposite is true. To use an extreme example, in the case where all stocks have the same return, which is the market return, dispersion is zero and there is no ability for anyone to outperform the market.

In Panel B, where stock returns are very spread out or dispersed, there are high rewards available for correctly picking the winners, but there are also high risks for backing the losers.

How Risky Is Reporting Season?

We now turn our attention to the Australian reporting season and investigate the dispersion of stocks over the two key reporting months; February and August. To do so we calculated the dispersion of S&P/ASX 200 stocks on a monthly basis over ten years, where dispersion is measured as the standard deviation of returns between stocks. Monthly dispersion numbers are then averaged across each calendar month over the sample period. Results are shown in Figure 3.

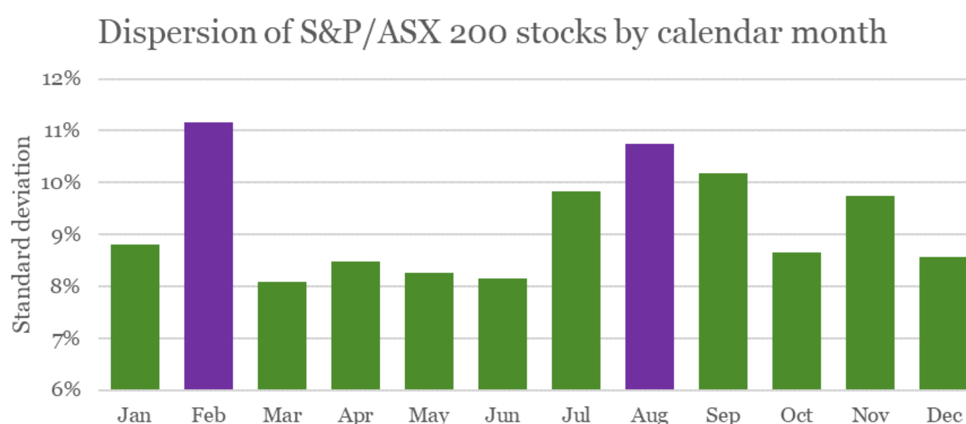

Figure 3: Dispersion of S&P/ASX 200 stocks by calendar month from 30 June 2009 to 30 June 2019. The data set includes the 148 current constituents of the S&P/ASX 200 index that have share price history available for over 10 years. Source: Bloomberg. Data as at 30 June 2019.

As anticipated, the two highest dispersion months are February and August. On average the dispersion across these two months is over 2% higher than over other months.

The conclusion that we draw from this is that reporting periods present both the biggest opportunity to beat the market, but also the biggest risk of lagging the market. For investors who do not have an edge, the risks of attempting to beat the market can be high.

So, what can the average investor do to avoid such risks?

Diversification using ETFs

Exchange traded funds offer a simple and easy solution. They allow investors to purchase an entire portfolio of ASX-listed stocks in a single trade. Low-cost diversification is a key feature of ETFs and this is exactly what investors need over periods where single-name risk and market dispersion is anticipated to be high.

Broad-based ETFs, which closely tracks the market, can be useful for riding-out risker periods, but investing in ETFs does not necessarily mean simply investing with the market.

It is still possible to take an active position, while diversifying-away single stock risk. ETFs offer a wide range of different exposures, most of which provide significant diversification benefits.

Fund in Focus: ETFS S&P/ASX 300 High Yield Plus ETF (ASX Code: ZYAU)

One strategy for reducing earnings-related volatility is to invest in high quality firms with stable income. ETF Securities offers a unique fund in this regard, which filters ASX-listed companies for both yield and quality.

ZYAU provides exposure to a selection of 40 Australian companies that have high dividend yields and/or share buy-back rates. To be eligible for inclusion the companies must have stable or increasing dividends and must generate *Free Cash Flow to Equity* above the amount of their distributions. This avoids companies who are using debt to finance unsustainably high yields and helps to identify high quality companies.

Companies with stable yields and strong cash flow generation tend to be well-established, stable businesses with strong balance sheets and may be less prone to negative earnings surprises.

Name	ETFS S&P/ASX 300 High Yield Plus ETF
ASX Code	ZYAU
Management Fee	0.35% per annum
Benchmark	S&P/ASX 300 Shareholder Yield Index
Inception Date	9 June 2015
Distribution Frequency	Quarterly
12 Month Yield	5.09% plus franking credits
Holdings	A full list of current holdings is available through the product PCF located **here**.

Performance

Total Return	3M	6M	1Y	3Y	Inception
ETFS S&P/ASX 300 High Yield Plus ETF	5.85%	13.82%	7.92%	11.33%	9.70%

Source: Bloomberg as at 31 July 2019. Returns for periods longer than 1 year are annualised. Past performance is not an indication of future performance.

In Summary

ZYAU offers investors a portfolio of high quality, yield-paying stocks on the ASX that can help achieve diversification in a single trade at a relatively low cost. This can be particularly powerful over reporting season, where returns in individual stocks tend to be more spread out and the risks from choosing the wrong stocks is higher.

ZYAU is currently yielding 5.09% p.a. plus franking credits and has consistently been one of the best performing Australian equity-income ETFs since coming to market in 2015.

GET MORE INFORMATION

To sign up for future Investment Research, email infoAU@etfsecurities.com.au

CONTACT ETF Securities

Sales
Phone: +61 2 8311 3488
Email: infoAU@etfsecurities.com.au

Trading
Phone: +61 2 8311 3483
Email: capitalmarkets@etfsecurities.com.au

Disclaimer

This document is issued by ETFS Management (AUS) Limited ("ETFS") (Australian Financial Services Licence Number 466778). This document may not be reproduced, distributed or published by any recipient for any purpose. Under no circumstances is this document to be used or considered as an offer to sell, or a solicitation of an offer to buy, any securities, investments or other financial instruments.

The information provided in this document is general in nature only and does not take into account your personal objectives, financial situations or needs. Before acting on any information in this document, you should consider the appropriateness of the information having regard to your objectives, financial situation or needs and consider seeking independent financial, legal, tax and other relevant advice having regard to your particular circumstances. Any investment decision should only be made after obtaining and considering the relevant product disclosure statement.

This document has been prepared by ETFS from sources which ETFS believes to be correct. However, none of ETFS, ETFS Capital Limited, nor any other member of the ETFS Capital Group, nor any of their respective directors, employees or agents make any representation or warranty as to, or assume any responsibility for the accuracy or completeness of, or any errors or omissions in, any information or statement of opinion contained in this document or in any accompanying, previous or subsequent material or presentation. To the maximum extent permitted by law, ETFS and each of those persons disclaim all any responsibility or liability for any loss or damage which may be suffered by any person relying upon any information contained in, or any omissions from, this document.

Investments in any product issued by ETFS are subject to investment risk, including possible delays in repayment and loss of income and principal invested. Neither ETFS, ETFS Capital Limited nor any other member of the ETFS Capital Group nor any of their respective directors, employees or agents guarantees the performance of any products issued by ETFS or the repayment of capital or any particular rate of return therefrom. The value or return of an investment will fluctuate and an investor may lose some or all of their investment. Past performance is not a reliable indicator of future performance.