ETFS Trade idea

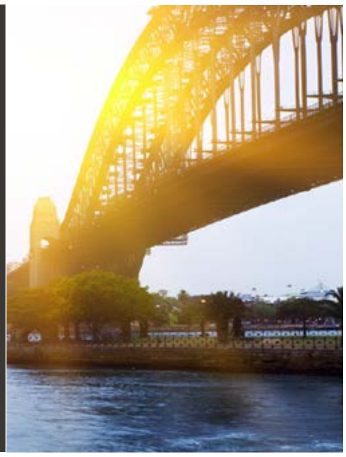
ETF Securities | The intelligent alternative | 22 August 2017

Unhappy with your dividend fund's performance?

Trade idea – ETFS S&P/ASX 300 High Yield Plus ETF (ZYAU)

Key Ideas:

- *Dividend strategies can be implemented in different ways to achieve different goals, which have their own pros and cons.*
- *Beware of dividend traps, chasing yield may lead to poor investment choices.*
- *Capital growth versus income generation – don't sacrifice one for the other.*



- **Dividend strategies can be implemented in different ways to achieve different goals.** Yield tilted strategies are popular amongst Australian investors, especially during low interest rate environments, with investors also wanting to get the tax benefits from the franking credits attached to dividends. The table below summarises the pros and cons of two commonly used dividend strategies: buy-and-hold and franking credit harvesting.

	Buy-and-hold	Franking credits harvesting
How to Implement?	Buy-and-hold a basket of high yield stocks to construct a portfolio with income yield higher than the broad market.	By rotating high yield stocks in the portfolio along with the dividend payment cycles to maximise franking credits.
Pros	• Higher income relative to the broad market; • Balance between capital preservation and income generation; • Lower portfolio turnover.	• More franking credits to boost after-tax returns; • Higher income returns versus the buy-and-hold strategy.
Cons	• Less franking credits.	• Sub-optimal portfolio due to aggressively chasing yield; • Higher portfolio turnover.

- **Beware of dividend traps, chasing yield may lead to poor investment choices.** Ultimately, a stock return should be a reflection of how well a company has managed to grow and therefore how much reward it passes back to shareholders. Sometimes a company may be too aggressive and use its cash-on-hand or leverage its balance sheet to pay dividends or buyback shares to meet investor expectations, but this can cause disappointment when investors realise the business outlook is not as promising as they thought.

  So, how do you avoid dividend traps?
  Dividend strategies have a higher risk of falling into dividend traps, especially for investors who are aggressively chasing yield or harvesting franking credits. It is easy to forget the invisible linkage between investment returns and fundamentals. Pay attention to companies which:

  1) Pay out too many dividends or fund share buybacks for more than what they have earned;
  2) Encounter stagnant business growth, measured by revenue/earnings, etc.

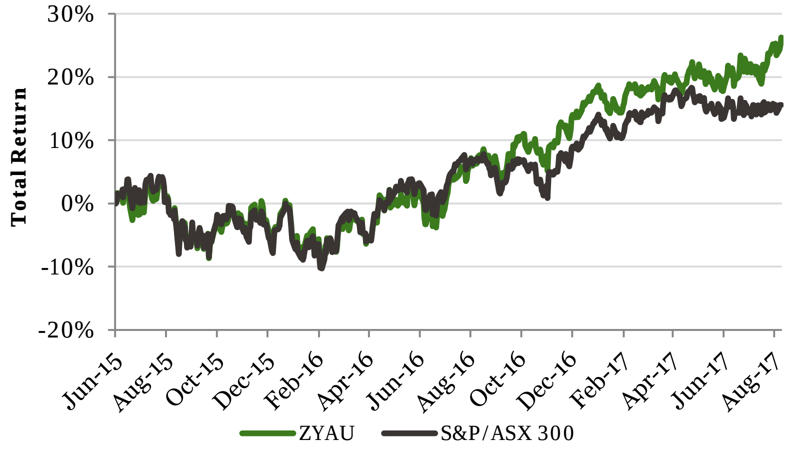
- **Capital growth versus income generation.** An effective dividend strategy should take a holistic approach to view income and capital gain as part of the total return. Investors should consider their own tax circumstances and assign reasonable weights to income and tax credits.

- **What does this mean for investors?** Investors wishing to pursue a dividend strategy which looks for capital growth as well as income may consider the **ETFS ASX/S&P 300 Shareholder Yield Plus ETF** . ZYAU offers exposure to a basket of the 40 highest yielding stocks measured by dividend and shareholder buyback within the S&P/ASX 300 index, with screenings like free-cash-flow to dividend and share buyback coverage to avoid dividend traps.

ZYAU's Filters in Action

In April's rebalance ZYAU's filters removed **Telstra Corp Ltd (ASX: TLS)** from the portfolio after the company had insufficient free cash flow to equity to cover dividends and share buybacks in the prior 12 months. The effectiveness of the filter was shown when the CEO of Telstra recently announced a planned dividend reduction, causing the share price to plunge by 10.6% on 17th August 2017. This reduced the performance of many other high yielding ETFs but left ZYAU unaffected.

ZYAU vs S&P/ASX 300 Performance



Performance	
ZYAU's since inception annualised total return	12.5%
S&P/ASX 300 annualised total return of the same period	7.2%
Distribution Yield	
ZYAU's 12-month yield	9.7%
ZYAU's benchmark index 12-month yield	4.5%
S&P/ASX 300 12-month yield	4.2%

Sources: Bloomberg as at 17 August 2017. NAV returns in AUD. Past performance is not an indication of future performance. ZYAU inception date is 9 June 2015.

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