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Why investors seeking asset diversification head for yield stocks



You can't make a decent return in cash; bonds are delivering historically low rewards and the outlook for stocks is uncertain. So is equity income the way forward? **Gabrielle Charlotte**

by **Chris Wright**

It's a hard time to make a buck. You can't make a decent return sitting in cash anymore; bonds are delivering historically low rewards – with government bonds in much of the world generating a negative yield for the first time in living memory – and the outlook for stocks is uncertain.

But diversifying from the mainstream is challenging, and for most of us requires professional assistance. In this series we will look at four interesting asset classes, and ask financial planners which fund managers they trust with their clients' money, and why.

We start with equity income, also known as [yield](#) stocks: an equity

portfolio, but one selected chiefly for the dividend income it generates.

"Retired clients like the concept of franking credits and high income-paying stocks," says Darren Johns, financial planner at Align Financial on Sydney's Northern Beaches. "We have used income or yield-focused Australian share funds for years."

Johns uses two for clients, both of them largely passive in nature: the Vanguard High Yield Australian Shares Fund and the BetaShares Australian Dividend Harvester Fund. The Vanguard product tracks the FTSE AFSA Australia High Dividend Yield Index, charging 0.9 per cent on the first \$50,000.

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Top earners

Key statistics for recommended equity income funds

	Annual fee (%)	Fund size (\$m)	No of holdings	Minimum investment (\$)	Top holdings
Vanguard High Yield Australian Shares Fund	0.90*	123	38	5,000	Wesfarmers Westpac
BetaShares Australian Dividend Harvester Fund	0.90	294	n/a	n/a	Transurban APA Group
IML Equity Income Fund	0.993	413	25	50,000	CBA AGL
Columbia Threadneedle's Global Equity Income Fund	1.05	51	79	n/a	Cisco Systems Reynolds Am
Henderson Global Equity Income Fund	1.00	6.7**	81	25,000	BAT Shell
ANZ ETFS S&P/ASX 300 High Yield Plus ETF	0.35	10.6	40	n/a	BHP Billiton Macquarie Grp
VanEck Vectors Morningstar Wide Moat ETF (MOAT)	0.49	985	43	n/a	Biogen Inc Amazon

* On the first \$50,000 ** As at Dec 2015

SOURCE: COMPANY WEBSITES

The FTSE AFSA Australia High Dividend Yield Index in turn focuses on ASX-listed companies with higher forecast dividends relative to their peers.

More ambitious

The BetaShares product is more ambitious, aiming to at least double the income yield of the broad Australian share market by rebalancing every two months in order to expose the fund to stocks that are about to pay a good dividend. It charges a 0.65 per cent management fee plus 0.25 per cent of expenses.

Other managers prefer an active approach. Phillip Win, senior financial planner at Profile Financial Services, recently included the IML Equity Income Fund from Investors Mutual into client portfolios. "What I like about them is that their process is very

valuation-driven," he says. "We have a focus on the preservation of capital – the 'don't lose me money' mentality."

The IML approach is to limit [capital downside](#) and increase yield by buying call options on the portfolio. Here's an example. If the fund manager holds shares of energy provider AGL and decides they would be happy to sell if the share price reaches a certain level, they sell call options that kick in at that particular price. The investor gets the premium for selling the call option – and if AGL's stock hits the level and the option is triggered, then the investor has also made money on the share price gain and was happy to sell at that level anyway. Some upside is sacrificed, but the option premium

provides more income. "And it's still valuation-led because I would have sold it at that level anyway," Win says. The management fee is 0.993 per cent, with no performance fee, and it aims to produce a yield 2 per cent above that of the S&P/ASX 300 Accumulation Index on a rolling four-year basis.

Some advisers look further afield than Australia for equity income. Nigel Douglas, chief executive officer of Douglas Funds Consulting, notes global equity income funds have been particularly popular and well-run in the UK. He highlights Columbia Threadneedle's Global Equity Income Fund available in Australia at an annual cost of 1.05 per cent, and the Henderson Global Equity Income Fund, "led by an experienced team with a long track record based on the well-founded application of a rigorous equity income investment process", Douglas says.

Twist on theme

Both these strategies seek [dividend yields](#) across both developed and emerging markets of at least 4 per cent, compared to an average of 2.5 per cent for the MSCI World index. "There tends to be a strong bias to sectors such as consumer staples, telecoms, financials and utilities," Douglas says. Typically, they have a value bias and so lag growth-led markets, but expect to outperform over the longer term. Unlike Australian funds, franking credits do not apply in international funds, and investors also need to consider currency risk. At OmniWealth, senior planner Genene Wilson – who historically has recommended direct equities – has started to see the benefits of exchange traded funds (ETFs). "This is not to say

there is not a place in some clients' portfolios for direct equities," she says. "But for the core of most client portfolios, ETFs just make more sense: it's hard to beat the market year in year out."

Some of her positions have a yield focus, and she uses the same BetaShares harvester product that Darren Johns does. She also uses the ANZ ETFS S&P/ASX 300 High Yield Plus ETF (with a management expense ratio of 0.35 per cent), which focuses on the top 40 highest yielding stocks.

A twist on the theme is the VanEck Vectors Morningstar Wide Moat ETF (MOAT), which she also uses. "Internationally, MOAT seeks high-quality companies rather than a yield play," she explains. The idea is to track companies with sustainable competitive advantages, which it does by following an index devised by Morningstar. While not exactly an equity income strategy, it's another example of a low-fee (0.49 per cent) passive vehicle providing equity exposure with a different way of thinking to the mainstream.

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