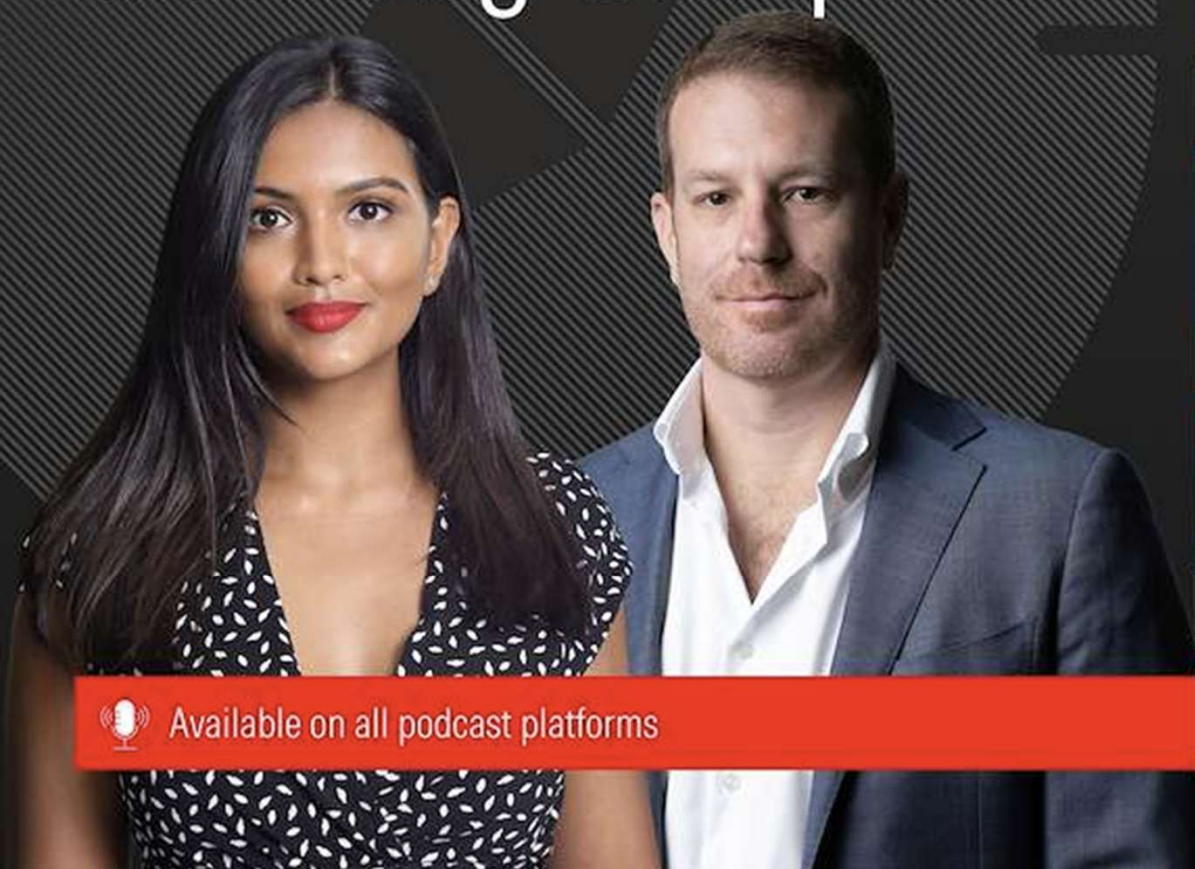




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Morningstar income investing bootcamp

Webinar 1 – Building an income portfolio

Webinar 2 – Assessing individual shares

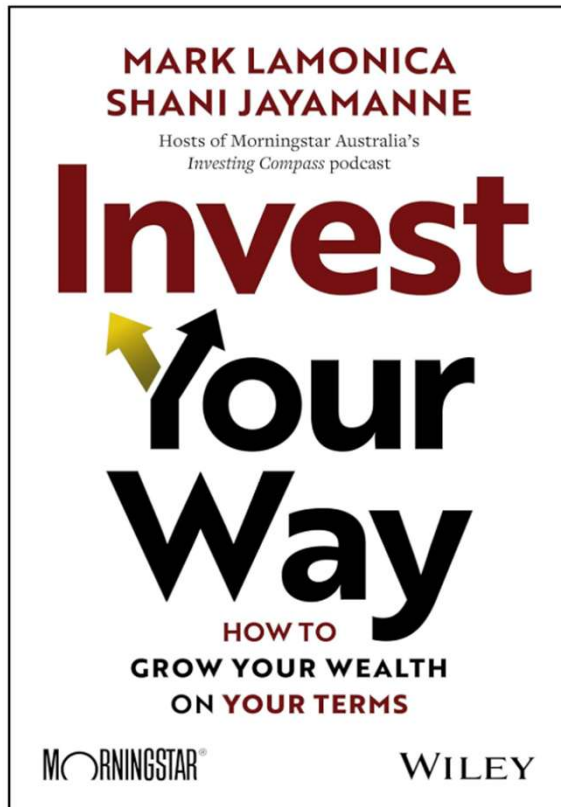
Webinar 3 – Using ETFs to generate income

Webinar 4 – Other income options (LICs, covered calls, dividend harvesting)

Learning objectives

1. Understand alternative approaches to generating income

Getting the foundations right



- The biggest issue many investors face is undermining their own outcomes by letting emotions influence decision making and making mistakes
- ETFs exacerbate these tendencies given the ease of trading, the proliferation of new ETFs and compelling marketing based on recent performance
- The key is adding structure to decision making by establishing goals, setting an investment strategy and developing a process to guide decision making

Covered call ETFs

A covered call strategy is a technique used to generate additional income from a portfolio of shares. The effectiveness in generating additional income is offset by limits on capital gains.

ETF holds a group of shares and sells call options. In exchange for the cash, the ETF gives the buyer of the call the right, but not the obligation, to buy the shares at a price above the current price of the shares.

If the shares rise in value the upside is capped because they are purchased by the holder of the call option. If the shares fall in value the ETF goes down in price. The trade-off is income consisting of the dividends from the shares and the cash from the call options.

Writer of option

- Holds 100 shares of CBA
- Receives 20 cents per share for writing on option with strike price of \$180 and expiration in one month

Buyer of option

- Will buy shares of CBA if the price is higher than \$180 plus the option cost at expiration

Example: BetaShares Australian Top 20 Equities Yield Maximiser Complex ETF (ASX: YMAX)

YMAX aims to generate attractive monthly income and reduce the volatility of portfolio returns by implementing an equity income investment strategy over a portfolio of the 20 largest blue-chip shares listed on the ASX. YMAX does not aim to track an index.



- Since 30 November 2012 the price return is -27.53
- Total return including income has been 6.43% a year
- The distribution yield is 8.10%
- Franking of 41.40% brings the gross yield to 9.50%

Dividend harvester ETFs

Dividend harvester ETFs typically rotate holdings to ensure they own dividend paying share when dividends are paid. Many harvester ETFs also hold ETFs with exposure to the overall market to balance their exposure to shares that are about to pay dividends.

How dividends work:

- **Declaration date:** This is the day that a company announces an upcoming dividend including the ex-date and pay date.
- **Ex-date:** The owner of a share prior to the ex-date is entitled to the dividends whether they own the shares on the pay date or not. On the ex-date financial theory states the share price drops by the dividend – if a share closes at \$20 the day before the ex-date and is paying a \$1 dividend it will open trading at \$19
- **Record date:** The record date is fairly meaningless and just reflects the settlement date of any transactions. The key is executing prior or after the ex-date.
- **Payment date:** The date the dividend is paid to shareholders eligible to receive a dividend.

There are various studies showing the actual fall on ex-date is less than the dividend with varying timing over the share price recovery.

Dividend harvester ETFs (continued)

Considerations for dividend harvester ETFs:

- High turnover may lead to short-term capital gains which may mask overall dividend component of ETF distributions
- There may be a degree of capital loss inherent in the strategies given the way dividends work and the relatively short-holding periods of shares
- The implementation approach matters and ineffective approaches may lead to poor investor outcomes

Example: Betashares Australian Div Hvstr Act ETF (ASX: HVST)

HVST follows a rules-based 'dividend harvest' strategy, which seeks to maximise HVST's exposure to dividend-paying Australian shares. The Fund's share portfolio is generally selected from the largest 100 Australian shares on the ASX, screened for high dividend and franking outcomes based upon expected future gross dividend payments.

The share portfolio is rebalanced approximately every three months, with the aim of including the shares that are expected, within the next rebalance period, to provide the highest gross yield outcomes. In order to increase security diversification, HVST additionally holds an allocation to broad sharemarket exposures through an ETF.

- Since 1 June 2022 the price return is 4.10%
- Total return including income has been 7.61% a year
- The distribution yield is 5.50%
- Franking of 63.60% brings the gross yield to 7.00%

LICs

A LIC is an actively managed collective investment vehicle and there are several structural advantages and disadvantages of including LICs as part of an income portfolio.

The company structure of a LIC allows the retention of profits and provides the LIC manager with the discretion to distribute income and franking credits at a time of their choosing.

This enables the LIC to smooth out any cyclicalities in the income of the underlying holdings and provide a stable stream of income and franking credits to investors.

Holding	2019	2020	2021	2022	2023
Vanguard Australian Shares (ASX: VAS)	0.26%	-46.70%	82.34%	85.29%	-45.40%
Australian Foundation Investment Company (ASX: AFIC)	33.33%	-25.00%	0.00%	0.00%	4.17%
Argo Ord (ASX: ARG)	4.76%	-9.09%	-6.67%	17.80%	4.55%
WAM Capital Ord (ASX: WAM)	0.00%	0.00%	0.00%	0.00%	0.00%

LICs (continued)

Another advantage is LICs can provide franking credits from a variety of assets and not just Australian shares. A LIC that invests in global shares can still have franking credits because the LIC is an Australian company which makes profits and pays taxes in Australia.

The closed end structure of a LIC has advantages and disadvantages. The LIC share price is set by supply and demand from investors and can deviate meaningfully from the value of the underlying assets. There is no mechanism to keep the net tangible assets (“NTA”) in line with the LIC price like an ETF or a fund.

Fixed interest ETFs

Bond yields have gotten more attractive lately but there are differences between the way a bond ETF and an individual bond act.

Investors should also be aware of how bonds fit into their overall goals and strategy including focusing on real – or post inflation – returns.