Income

Not all equity income products are created equal….

For Adviser use only

As interest rates plumb new lows, the search for income increasingly turns from fixed interest to equities.

Blue chip equities that provide franked dividends have long been a popular and tax-effective source of income for many individual investors.

Those less concerned with franking have also had the option to invest in relatively high yielding property and infrastructure securities.

Unsurprisingly, investment managers have responded to investor demand for income yielding equity investments, resulting in a proliferation of income-focused managed funds, SMAs and ETFs.

While income may be a common theme, there are significant differences between the options available. These include, differences in:

- objectives
- benchmarks
- calculation of yield
- performance reporting
- fees, and;
- minimum investment size.

Comparison is not simple. Think mobile phone plans or health insurance! To highlight the differences, but still make meaningful comparisons, we have focused on equity income investments that have been operating for some years and have substantial funds under management. This article highlights how diverse even a small selection of Australian equity income products can be – we do not name or recommend any product but note that our review included eight income focused products that used S&P Indices as benchmarks and are among those with the largest funds under management. Almost all are actively managed.

Our analysis reveals the importance of investors being clear in what they want from an income investment and looking closely to ensure the product they select is seeking to deliver the outcome they want.

Objectives

These can vary from general to specific and may have one or both of income and capital growth components. They typically relate to the benchmark but may be pre or post tax, gross or net of fees, grossed up for franking credits, calculated over varying time periods or an assortment of them all.

Five out of the eight products have a stated income or yield objective that relates to a benchmark although yield varies from gross to after tax. Only two of the products with a yield objective also have a stated capital growth objective. And only one of the products with a stated yield objective has a total return objective relative to a benchmark. For the three products that simply have a total return objective relative to a benchmark, two are pre-fees and one is after fees. Put simply, there is a lot of variation between objectives as Table 1 highlights.

Table 1: Fund objectives

Fund	Fund objectives					
	Income / Yield		Capital Growth		Total Return	
A	✓	Tax-effective income > Benchmark (BM) Income	✓	Moderate >5yrs	✗	
B	✓	Gross yield > Gross BM yield	✗		✓	> BM after fees
C	✓	Yield > BM yield	✓	Long term	✗	
D	✓	After tax yield > BM yield	✗		✗	
E	✗		✗		✓	>BM after fees >3yrs
F	✗		✗		✓	>BM before fees >3yrs
G	✓	Yield > (BM +2%)	✗		✗	
H	✗		✗		✓	= BM pre-fees

Source: Fund factsheets and PDS; January 2020

Benchmarks

Several providers use specially created indices as their benchmarks, most use Total Return (TR) but some do not, some have a universe of the ASX 200, others use the ASX 300 and another specifies Industrial Shares. The performance of these benchmarks varies significantly as Table 2, below, highlights.

Table 2: Performance Comparisons for Major Indices[1]

As of: Feb 28, 2020

	Returns (%)	Annualised Returns (%)			
	3 Month	1 Year	3 Year	5 Year	10 Year
S&P/ASX 300 (TR)	-5.2	8.7	8.6	6.2	7.9
S&P/ASX 200 Franking Credit Adjusted Annual Total Return Index (Tax-Exempt)	-5.2	10.3	10.1	7.7	9.6
S&P/ASX Dividend Opportunities Index TR	-8.3	1.4	3.2	1.5	4.7
S&P/ASX 200 (TR)	-5.2	8.6	8.6	6.2	8.0
S&P/ASX 200 Industrials (TR)	-3.7	12.3	7.8	6.0	10.0
Difference between highest and lowest (%)	**4.6**	**10.9**	**6.9**	**6.2**	**5.3**

Source: S&P Dow Jones Indices LLC.

The launch date of the S&P/ASX 300 was April 3, 2000.The launch date of the S&P/ASX 200 Franking Credit Adjusted Annual Total Return Index (Tax-Exempt) was November 24, 2014.The launch date of the S&P/ASX Dividend Opportunities Index was September 21, 2010.The launch date of the S&P/ASX 200 was April 3, 2000.

All information presented prior to the index launch date is back-tested. Back-tested performance is not actual performance, but is hypothetical. The back-test calculations are based on the same methodology that was in effect when the index was officially launched. Past performance is not an indication or guarantee of future results. Please see the Performance Disclosure at http://www.spindices.com/regulatory-affairs-disclaimers/ for more information regarding the inherent limitations associated with back-tested performance.

1 We have used only S&P Indices as this data was readily available.

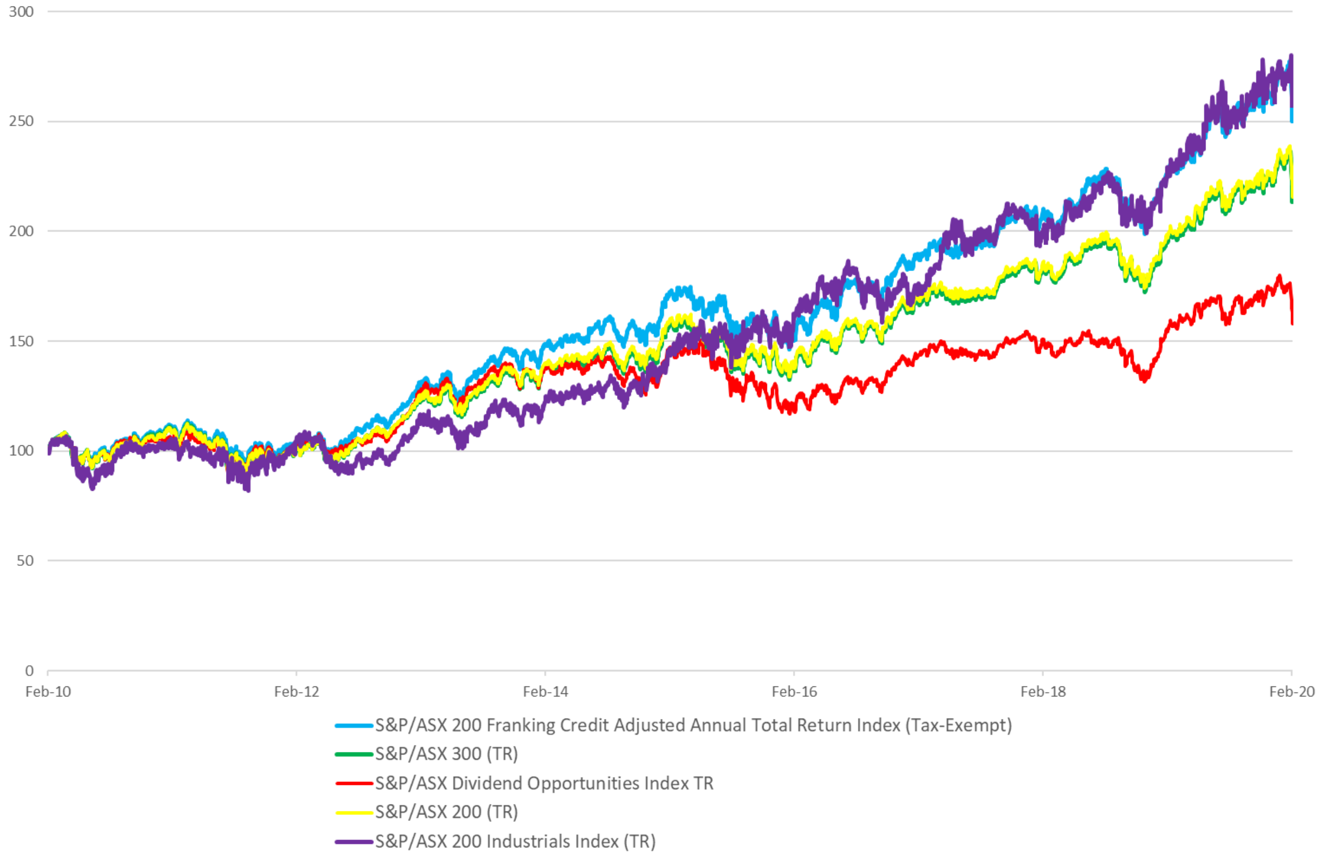
Source: S&P; March 2020

For example, over a one-year period there was a 10.9% difference between the returns of the best and worst performing benchmark indices, a 6.9%pa difference after three years and a 6.2%pa difference after five years.

Hence, outperformance relative to the benchmark with the lowest returns could equate to a substantial underperformance in relation to the benchmark with the highest return.

The S&P/ASX 200 Industrials (TR) Index has delivered the highest returns of the major benchmarks (S&P/ASX 200TR and S&P/ASX 300TR) over 10 years to 28 February 2020. Chart 1 illustrates this cumulative impact over the last decade.

Chart 1: S&P/ASX Index performance comparison



*Data has been rebased to 100
Source: S&P; March 2020

Yield calculation

Income may be gross, inclusive of franking credits and special dividends, or may have a broad objective such as being tax effective.

Comparisons with benchmark yield are not simple, as yield is not typically reported and must be calculated.

An example of benchmark yield performance for the three major indices in Table 3 reveals a much closer range, with differences of 0.12% p.a. over three years between them, 0.16% over five years and 0.56% over 10 years. The S&P/ASX 200 Industrials was consistently the highest yield. The figures are not grossed up for franking credits.

Table 3 Index yield comparisons

As at: 29 Feb 2020

Income Return (%)	QTD	YTD	1 Year	3 Year	5 Year	10 Year
S&P/ASX 200 - Income Return	0.55	0.55	4.23	4.51	4.50	4.64
S&P/ASX 200 Industrial - Income Return	0.60	0.60	4.41	4.59	4.63	5.16
S&P/ASX 300 - Income Return	0.54	0.54	4.20	4.47	4.47	4.60
Difference between highest and lowest (%)	**0.06**	**0.05**	**0.21**	**0.12**	**0.16**	**0.56**

Source: S&P; MLC Investments; March 2020

Some funds use yields that have been grossed up to include franking credits. This can boost the overall yield considerably.

For example, one fund reports that its income or realised yield for a one-year period comprised approximately 70% cash and 30% franking - which effectively means that the total reported income is 40% higher than cash income because franking credits are included. The proportions were the same over an eight-year period as Table 4 demonstrates.

Table 4: Impact of including franking in yield calculation

Realised Yield (%)	One year	% of total income	Since Inception (8yrs)	% of total income
Cash (%) pa	8.7	71	6.9	72
Franking (%) pa	3.5	29	2.7	28
Total Income (%) pa	**12.2**	**100**	**9.6**	**100**
Extent that Total Income exceeds Cash (%)	**40**	**-**	**39**	**-**

Source: Fund reports; Antares Equities

Other funds report "distribution return" which can include net realised capital gains and not just income.

While there is not a big variation in the income returns between the major benchmarks used by these funds, there can be substantial differences in what and how the funds choose to report income.

Performance reporting

Not all reporting reflects the stated investment objective of the investment product.

Most funds report Total Return and compare it to a Total Return benchmark. Yet this is often not the investment objective, or may be only part of the objective. Some reporting excludes the benchmark, others include it but do not separately calculate relative performance.

Gross or realised income, capital growth and total return are all variations used in performance reporting. Only half the funds reported specifically on income and several funds had no income benchmark.

Fees

Fees matter, especially over the long term. Of the investment vehicles we sampled, the management fee varied from 0.3% of assets under management to a maximum of 1.8%, with the majority at around 0.9%. Costs of entry / exit are another source of variation, with ETFs incurring brokerage while managed funds have different buy / sell spreads. The sample ranged from 0.15% to 0.25%.

Table 5: Fee comparison

Product	Management Fee	Buy-Sell spread / brokerage
A	0.60%[2]	+0.15% / -0.15%
B	0.90%	+0.20% / -0.20%
C	0.99%	+0.15% / -0.15%
D	0.85%	+0.25% / -0.25%
E	0.92%	+0.20% / -0.20%
F	Max of 1.8%	+0.20% / -0.20%
G	0.993%	+0.25% / -0.25%
H	0.30%	brokerage

Source: Fund factsheets and PDS; January 2020

[2] Inclusive of GST, net of reduced input tax credit

Transparency
Transparency ranges from daily reporting of each holding within the fund, typically by ETFs, to monthly reporting which usually includes the Top 10 holdings – most with, but some without, their weighting within the fund.

Minimum investment size
With ETFs the minimum investment size is $500 which is the minimum order on the ASX. The minimum for managed funds varies according to whether they are retail, direct investment or on a platform (as is the case for SMAs).

For the funds we sampled, most minimums ranged from $20,000 to $100,000 compared to a platform minimum for one of the funds of $1,000.

Conclusion
From just a small selection of the more established larger equity income products it is apparent there is a substantial variation in objectives, benchmarks, yield calculations, reporting, fees, transparency and minimum investment size.

Being clear as to what you are looking for in an equity income product is only the first step. Reading the fine print or seeking advice on which products are designed for you is also important.

Legal Disclaimer

NOT INTENDED FOR OR TO BE DISTRIBUTED TO RETAIL INVESTORS

This Document is provided by Antares Capital Partners Ltd ABN 85 066 081 114, AFSL 234483 (“ACP”) and its investment management division trading under the name of “Antares Equities”.

This document has been prepared for licensed financial advisers only. This document must not be distributed in any way to “retail clients” (as defined in the Corporations Act 2001 (Cth)) or any other persons.

This information may constitute general advice. It has been prepared without taking account of individual objectives, financial situation or needs and because of that you should, before acting on the information contained in this document, consider the appropriateness of the advice having regard to your personal objectives, financial situation and needs. Antares recommends that you obtain professional advice and read any relevant available information pertaining to the information contained in this document and obtain professional independent financial advice to determine whether the information contained in this document is suitable for you and your investment needs.

ACP is a subsidiary of the National Australia Bank Limited group of companies. An investment in any financial product offered by any member company of the National Australia Bank group of companies is not a deposit with or liability of, and is not guaranteed by National Australia Bank Limited or its subsidiaries and is subject to investment risk, including possible delays in repayment and loss of income and capital invested.

This document has been prepared in good faith, where applicable, using information from sources believed to be reliable and accurate as at the time of preparation, no representation or warranty (express or implied) is given as to its accuracy, reliability or completeness (which may change without notice). Any opinions expressed in this document constitutes ACP’s judgement at the time of issue and is subject to change.

ACP believe that the information contained in this document is correct and that any estimates, opinions, conclusions or recommendations are reasonably held or made as at the time of compilation. However, no warranty is made as to their accuracy or reliability (which may change without notice) or other information contained in this communication.

Past performance is not a reliable indicator of future performance. Returns are not guaranteed and actual returns may vary from any target returns described in this document. Any projection or forward looking statement in this document is provided for information purposes only and no representation is made as to the accuracy of such projection or that it will be met. In some cases the information is provided to us by third parties, while it is believed that the information is accurate and reliable, the accuracy of that information is not guaranteed in any way.

None of ACP, any other member or the NAB Group, or the employees or directors of the NAB Group are liable for any loss arising from any person relying on information provided by third parties. This information is directed to and prepared for Australian residents only. ACP disclaims all responsibility and liability for any loss, claim or damage which any person may have and/or suffer as a result of any persons reliance on any information, predictions, performance data and the like contained within this document, whether the loss or damage is caused by, or as a result of any fault or negligence of ACP, it’s officers, employees, agents and/or its related bodies corporate.

Bloomberg Finance L.P. and its affiliates (collectively, Bloomberg) do not approve or endorse any information included in this publication and disclaim all liability for any loss or damage of any kind arising out of the use of all or any part of any such information.