

## FAQ: Not all Dividend Distributions are the Same

Investing in dividend-paying companies has proven to be a successful investment strategy in the Australian equity market. Over the past 30 years, dividends have accounted for more than a third of the total return from an investment in Australian shares.<sup>1</sup> An effective way to invest in dividend-paying companies is through an Exchange Traded Fund (ETF) that tracks a high dividend index. ETF investors receive dividends of the underlying companies through regular distributions. However, not all distributions are created equally. The below outlines a number of important factors investors should keep in mind while selecting the investment that best fits their strategy.

### Q: WHAT IS THE BEST WAY TO EVALUATE THE PERFORMANCE OF A DIVIDEND-FOCUSED STRATEGY?

A: Typically, dividend-focused investors look for investments that provide strong, regular and stable income, but are often reluctant to remove all aspect of capital growth from their investment. A dividend investment strategy is considered a success if it can produce strong and steady income while maintaining or growing capital base over time. Distribution income alone is less meaningful without taking into account the total return from the investment (eg: income and capital growth) and a dividend-focused ETF investment should be evaluated in light of both aspects.

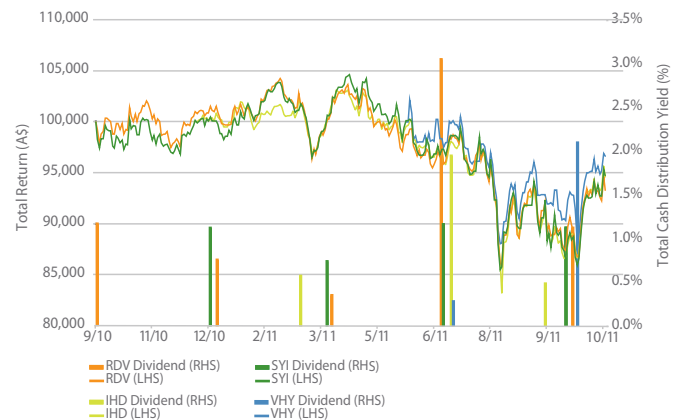
Investors should keep in mind that not all ETF distributions are the same. Firstly, the distribution stream that comes from steady and sustainable dividend income of the underlying securities is considered “high quality” and thus desirable. Any additional tax benefit from the distribution (eg: franking credits) can also add value to an investment final outcome.

Additionally, investors should be wary of strategies that aim to boost income at the cost of depleting capital; for example, dressing up capital as income through unnecessary trades or return-of-capital distributions.

### Q: WHAT DOES THE TOTAL RETURN (CAPITAL GROWTH + DIVIDENDS) OF DIVIDEND-FOCUSED ETFS LISTED ON THE AUSTRALIAN SECURITIES EXCHANGE (ASX) LOOK LIKE?

A: Below is an example of total return of a \$100,000 investment from September 2010 to October 2011 for all ASX listed dividend-focused ETFs.

**FIGURE 1: GROWTH OF \$100,000 AND CPU DISTRIBUTIONS**



RDV- Russell High Dividend Australian Shares ETF, Inception Date: May 2010 ; SYI- SPDR MSCI Australia Select High Dividend Yield Fund, Inception Date: 30 September 2010; IHD- iShares S&P/ASX High Dividend, Inception Date: 6 December 2010; VHY- Vanguard Australian Shares High Yield ETF, Inception Date: 23 May 2011

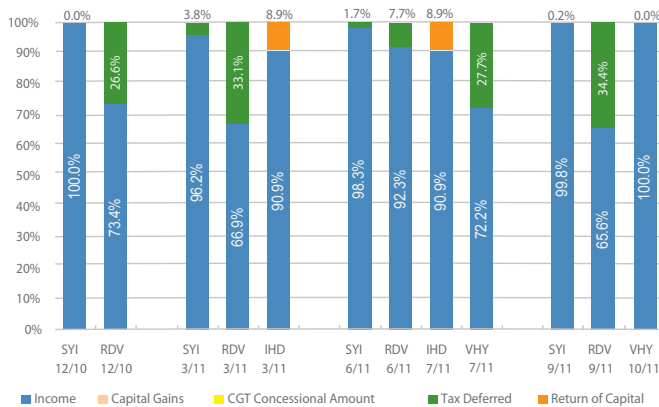
Source: SSGA, FactSet, as at October 2011. Total return performance is based on listed price sourced from FactSet, adjusted for total distribution paid. Past performance is not an indication of future performance.

### Q: HOW CAN AN INVESTOR DETERMINE IF THE DISTRIBUTION COMES FROM UNDERLYING DIVIDENDS OF THE ETFS?

A: Distribution statements, generally made available by fund managers, provide a detailed listing of distribution components. These statements allow the investor to examine what percentage of their distribution is derived from dividends of the fund’s underlying constituents as opposed to other components, such as capital gains, tax deferrals or return of capital.

For example, the illustration below provides a breakdown of distribution components of dividend-focused ETFs listed on the ASX. Investors should be aware of non-income distributions (eg: tax deferrals and capital returns) and ensure they understand how the distributions on their investments are derived.

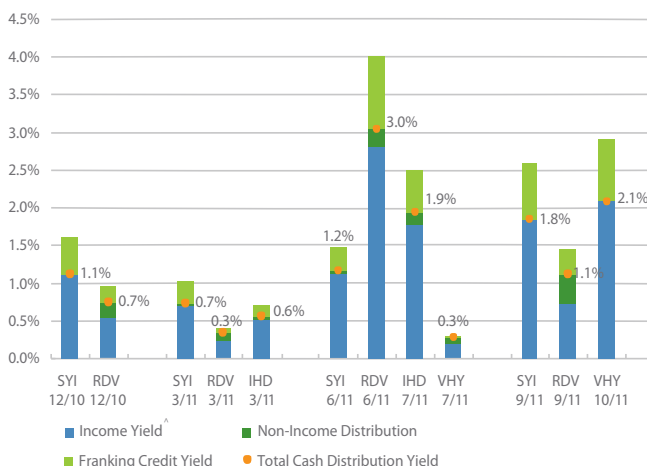
**FIGURE 2: DISTRIBUTION COMPONENTS**



IHD does not provide detailed distribution components of its interim distributions. Source: SSGA, ASX announcements and ETF provider websites. Where interim dividend information is not provided, they are estimated using the full financial year distribution data. Past performance is not an indication of future performance.

In addition to distribution components, domestic tax-paying investors should also examine the tax efficiency of their dividend-focused investment by taking into account the level of franking credit the investment provides. Figure 3 shows the dividend yields (calculated using closing price on ex-dates) and franking credit levels of ASX-listed dividend-focused ETFs for the last four quarters. All else being equal, a distribution with higher franking credits provides a higher level of tax efficiency.

**FIGURE 3: COMPARING YIELDS OF DIVIDEND-FOCUSED ETFs WITH ADDED FRANKING CREDIT DISTRIBUTION**



IHD does not provide detailed distribution components of its interim distributions. Source: SSGA, ASX announcements and ETF provider websites. Where interim dividend information is not provided, they are estimated using the full financial year distribution data. ^ Income Yield is calculated as all cash income (e.g., interest, unfranked dividend, franked dividend, foreign income, other income) divided by closing prices on ex-dates. Franking credit yield is calculated as franking credit per unit divided by closing prices on ex-dates. Total cash distribution yield is calculated as cash distribution per unit divided by prices on ex-dates. Past performance is not an indication of future performance.

**Q: HOW ARE THE DISTRIBUTIONS OF AN ETF CALCULATED? HOW DO THEY DIFFER FROM QUOTED INDEX DISTRIBUTION YIELDS?**

A: An ETF receives dividends and distributions from the underlying securities it holds. These dividends and distributions, after fees and expenses, will be distributed to ETF holders at the end of each distribution period (usually quarterly for dividend-focused ETFs). Note that there is usually a time lag between ex-dates of the underlying dividends and when those dividends are paid out to ETF holders. The ETF distribution amounts will include dividends that have been received (eg: not dividend receivables).<sup>2</sup>

In contrast, the commonly quoted dividend and index yields are usually calculated using ex-dates. Investors should take the timing differences into account when comparing these measures with ETF distributions. For example, the published dividend yield of an underlying index includes the receivables of underlying dividends at the end of the quarter where an ETF distribution does not include the receivables until the following quarter.

**Q: DO OFF-MARKET SHARE BUY-BACKS ENHANCE THE TOTAL PERFORMANCE OF A FUND?**

A: An Australian off-market share buyback may be a highly effective form of returning surplus capital to shareholders, as the current tax legislation (in conjunction with the current practice of the ATO) allows buyback companies to buy their shares at a discount to the prevailing market price (up to a maximum discount as generally determined by the company and the ATO).<sup>3</sup> It is necessary to determine the capital / dividend split in respect of the buyback under the relevant rules. As the dividend component should be frankable, it may be advantageous for some shareholders to participate in the buyback as they may receive franking credits in respect of the dividend component. For example, with the BHP off-market buyback in April, A\$40.57 of the A\$40.85 tender price was treated as deemed fully franked dividends.<sup>4</sup>

However, not all investors can benefit from tendering shares at lower than market price. This may be the case in respect of certain top marginal rate investors. Additionally, potential transaction and other market costs may also lower the benefits from participating in buyback.

Though the buyback program provides benefits to some investors, it may be at the expense of others. Appreciating the diverse groups of investors and their varying circumstances, we note that SPDR® ETFs do not participate in any off-market share buyback programs.



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For more information about our ETFs or how to invest, please call +612 9240 7600 or email [info@spdrs.com.au](mailto:info@spdrs.com.au).

### IMPORTANT RISK INFORMATION

<sup>1</sup> State Street Global Advisors, as of 30 June 2011.

<sup>2</sup> To minimise tax distortions, the dividends should be distributed to ETF holders (as part of the ETF distribution) in the year they are included in the assessable income of the Fund. Generally, dividends will form part of the assessable income of the fund in the year they are received. Note the position is different if the underlying securities of the Fund are REITs or Managed Investment Schemes (MIS), since the Fund would usually be assessed on the basis of its present entitlement to income from those investments, which may include receivables.

<sup>3</sup> See Practice Statement Law Administration PL SA 2007/9. There is exposure draft legislation to change the existing rules governing share buybacks.

<sup>4</sup> BHP News Release (#12/11) on ASX, 11-April-2011.

<sup>5</sup> Bloomberg, as of 30 September, 2011.

<sup>6</sup> As of 30 September 2011. This AUM includes the assets of the SPDR Gold Trust (approx. US\$64 billion as of 30 September 2011), for which State Street Global Markets, LLC, an affiliate of State Street Global Advisors serves as the marketing agent.

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