TRENDS & IDEAS

BUY SIDE TELLS ADVISORS WHERE TO GO FOR CONSISTENT YIELD

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TAKEAWAY: Here are examples of ETFs that could constitute a diversified dividend portfolio.

POSITIVE IMPLICATIONS:

iShares iBoxx $ High Yield Corporate Bond Fund	NA	[HYG]
SPDR Barclays Capital 1-3 Month T-Bill ETF	NA	[BIL]
SPDR Barclays Capital High Yield Bond ETF	NA	[JNK]
SPDR S&P China ETF	Marketweight	[GXC]
SPDR S&P Dividend ETF	Overweight	[SDY]
Vanguard Short-Term Bond Index Fund; ETF Shares	NA	[BSV]
Vanguard Total Bond Market Index Fund; ETF Shares	NA	[BND]

With interest rates on traditional income-producing assets like government bonds likely remaining low through late 2014, many advisors continue to struggle with how to help their clients reach income goals and, for some, make up for lost time.

"We believe the answer is through the 'DID' approach," says Mitch Reiner, principal, managing partner and founding partner of Wela Strategies. Reiner, who is also an investment advisor as well as the chief operating officer of the wealth management firm Capital Investment Advisors, presented his long-term strategies during an S&P Indices webinar on April 17 entitled "The Hunt for Yield: Generating Income with Dividends." S&P Indices operates independently of S&P Capital IQ.

DID is the acronym that Reiner uses to describe the "three sleeves" of his investment strategy: to garner Dividends from stocks, Interest from bonds, and Distributions from alternative sources, such as closed-end funds, preferred stock, convertible bonds, master limited partnerships (MLPs), royalty trusts, and real estate investment trusts (REITs).

"We think the answer is to create a basket of income-producing assets that are relatively uncorrelated to create a sustainable income stream," says Reiner.

But acknowledging that this type of strategy can get complicated if advisors intend on managing all the individual components of his DID strategy, Reiner believes that advisors can mostly use exchange-traded funds (ETFs).

"There are plenty of places with ETFs where you can get yield," Reiner notes, adding that "overall, you can range between duration and credit risk with each of the different types of investment associated here and whether you want to be in something that is more equities or more fixed income."

For more yield, "you can go all the way to the top with a high-yield bond index ETF," he says, and as examples he points to iShares iBoxx $ High Yield Corporate Bond Fund (HYG 91 NR) or SPDR Barclays Capital High Yield Bond ETF (JNK 40 NR). HYG, which tracks the iBoxx $ Liquid High Yield Index, recently paid a dividend yielding 7.3%, while JNK, which tracks the Barclays Capital High Yield Very Liquid Index, boasted a 7.4% yield. Effective duration on HYG is 4.24 years, while for JNK it's 4.5 years.

Reiner also points out that those who want less risk can consider Vanguard Total Bond Market Index Fund; ETF Shares (BND 84 NR), where average duration is 5.1 years. The ETF, which tracks the Barclays Capital Aggregate Bond Index, recently paid a dividend yielding around 3%.

For the short-term investor who is looking to take on more risk for capital appreciation, Reiner offers that advisors may want to consider ETFs tracking the Barclays Capital 1-3 Month US Treasury Bill Index. Examples, he says, could include "something like" a SPDR Barclays Capital 1-3 Month T-Bill ETF (BIL 46 NR), or Vanguard Short-Term Bond Index Fund; ETF Shares (BSV 81 NR). Year to date to April 25, 2012, the Barclays index returned 11.3%.

With regard to equity ETFs, Reiner echoes the views of S&P Capital IQ ETF analyst Todd Rosenbluth, another webinar presenter. "No. 1 is the index strategy. That's the most important thing. Like Todd was saying, it's not about the ETF or what it's doing. It's about what's inside of it. So personally, we prefer dividend growers to the highest yielders. That's just a personal strategy," Reiner says.

Reiner says this is why he prefers ETFs tracking the S&P High Yield Dividend Aristocrats Index, such as the SPDR S&P Dividend ETF (SDY 57 Overweight), over others that track the Dow Jones Select Dividend Index. As described by S&P Indices Senior Analyst Howard Silverblatt, companies within the Dividend Aristocrats Index have increased their dividend 25 years in a row.

"It's part of their culture, their cash-flow, planning - it's dedication to shareholder return. They have had the ability to do 25 years in a row of increased dividends. It shows growth and the ability to survive shocks. These are household names with existing products, sales and cash flow: Coca-Cola (KO 76 *****), ExxonMobil (XOM 86 *****), McDonalds (MCD 96 *****), Wal-Mart (WMT 57 ****). Customers know them. Investors know them," Silverblatt explained to webinar participants. In addition to growing dividends consistently, the aforementioned stocks are all highly ranked by S&P Capital IQ equity analysts as "strong buys" or "buys."

"In assessing the overall quality of an equity ETF, S&P Capital IQ's philosophy is that an important attribute of a strong equity ETF is constituent stocks we believe are undervalued. Thus, in generating the S&P Capital IQ ETF ranking, we take a close look at the quality of the equity ETF's constituents and incorporate that assessment into the ranking," Rosenbluth explained in the webinar. S&P Capital IQ provides rankings on more than 660 equity ETFs.

Costs matter for advisors who are considering ETFs, and that is why Reiner would prefer SPDR S&P China ETF (GXC 70 Marketweight), which would cost his firm 59 basis points to garner a 2.1% 30-day SEC yield, as opposed to a higher-yielding fund with higher expenses, such as iShares FTSE China 25 Index Fund (FXI 38 Marketweight), with 72 basis points of fees and a 30-day SEC yield of 2.4%.

S&P Capital IQ's ETF-Ranking Methodology places an emphasis on assessing various dimensions of an ETF before making an investment decision. This includes independently assessing which securities an ETF owns to decide if the investments have relatively strong fundamentals and are undervalued; evaluating the level of risk the ETF is taking on through the assets it owns, and how much risk is indicated by the volatility of the ETF's performance, when compared with other ETFs; and lastly, appraising the cost implications for purchasing and owning the ETF. To see what S&P Capital IQ thinks of the ETFs listed, visit the ETF tab of MarketScope Advisor.

ISABELLE SENDER, S&P Capital IQ Editorial