



# Equity and Preferred Stock Income ETFs

The use of equity income ETFs to boost portfolio yields

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# Where's the Yield?

- Portfolio yields are under pressure due to the flight to safety over the last few years.
- New investments in bonds have greater principal risk than in years past due to the current high prices
- Conservative and Income Growth allocation models are under the most pressure in this environment
- Reallocating a portfolio from bonds to stocks carries increased overall portfolio risk, reducing the ability of the portfolio to soften the “blow” from the next crisis or even modern day volatility.

# Sample Income Growth Allocation

Asset Class	Allocation %	Yield (ETFs)	Standard Deviation (Index)
Large Cap - SPY	10%	1.8	22.03
Mid Cap - IJH	6%	1.06	26.1
Small Cap - IJR	3%	1.08	27.67
Developed Intl - EFA	8%	2.41	26.45
Emerging Mkts- VWO	3%	1.7	33.48
US Agg Bonds	28%	3.47	4.23
Short Duration TIPS	10%	1.09	8.86
US High Yld Bnd	8%	8.37	17
Emrg Mkt Bond	8%	5.19	12.76
Intl Treasuries	3%	2.27	10.98
US Corp Short Term Bnd	3%	.72	2
Commodities	3%	0	24.84
CASH	10%	.25	
5.78% 5yr Annualized Rtn	100%	2.7 <small>(12mo)</small>	9.6 (5yr) 18 (SPY)

# Sample Portfolio Disclosure

- Some ETF data is not available for a 5 year look back. We are using the index data for standard deviation and rates of return which will not take in to account ETF tracking error or ETF fees.
- Yield is derived from the ETFs listed 12mo yield.
- All data was collected from MorningStar.

# Selecting an Equity Income ETF

- Large Cap Equity Income ETF Options
  - SPDR S&P Dividend ETF (SDY)
    - S&P High Yield Dividend Aristocrats Index
      - Designed to measure the performance of the 60 highest dividend yielding S&P Composite 1500 constituents which have followed a managed dividends policy of consistently increasing dividends every year for at least 25 years. Additional index methodology can be easily viewed at [www.standardandpoors.com](http://www.standardandpoors.com)
  - Morningstar Data Quick Notes
    - Category - Large Cap Value
    - Note: 17% Giant, 34% Large, 39% Mid, 9% Small Cap
    - Currently 60 companies, 12-mo yield 3.35%
    - Expense Ratio 35 bps; \$5.2B AUM; 44% Turnover
    - 5-yr return 3.31%; 5-yr Standard Deviation 18.63

# Selecting an Equity Income ETF

- Large Cap Equity Income ETF Options (con't)
  - iShares Dow Jones Select Dividend - DVY
    - Dow Jones Select Dividend Index
      - 100 of the highest dividend-yielding companies (excluding REITS) on the Dow Jones US Index
      - Additional index methodology can be easily viewed at [www.djindexes.com](http://www.djindexes.com)
    - Morningstar Data Quick Notes
      - Category - Large Cap Value
      - Note: 11% Giant, 37% Large, 35% Mid, 15% Small Cap
      - Currently 100 companies, 12-mo yield 3.4%
      - Expense Ratio 40 bps; \$6.1B AUM; 25% Turnover
      - 5-yr Return -.20; 5-yr Standard Deviation 19.02

# Selecting an Equity Income ETF

- Large Cap Equity Income ETF Options (con't)
  - Vanguard Dividend Appreciation ETF - VIG
    - Mergent Dividend Achievers Select Index (made for Vanguard)
      - U.S.-listed companies that have increased their annual regular dividends for at least the past 10 consecutive years and have met specific liquidity screening criteria.
  - Morningstar Data Quick Notes
    - Category - Large Cap Blend
    - Note: 50% Giant, 35% Large, 12% Mid, 2% Small Cap
    - Currently 142 companies, 12-mo yield 1.99%
    - Expense Ratio 20 bps; \$4.6B AUM; 20% Turnover
    - 3-yr Return .2; 3-yr Standard Deviation 18.69

# Large Equity Cap Income

- Usage of ETFs
  - VIG - Used in core asset allocation strategies and could replace other value/growth neutral core holdings, increasing yield. Financials make up 6% of holdings.
  - SDY - Used in portfolios where growth and value holdings are strategically allocated. Traditional large and mid cap holdings could be reduced and SDY used to supplement portfolio yield with equity dividends
  - DVY - More tilted towards value compared to SDY and carries more small cap equities. 70% of holdings are in Manufacturing. Can be used as an alternate to SDY but should not be considered an apples to apples comparison.

# Preferred Stock

- Benefits
  - Equity returns
  - Higher Yield than common stock
    - Currently 7.32% 12mo Yield for iShares' PFF
- Drawbacks
  - Volatility greater than the S&P 500
  - 5 Yr rate of return less than the S&P 500
  - Preferreds have a large exposure to the financial sector, thus did not hold up well during the credit crisis.

# Top 4 Preferred Stock ETFs

- iShares S&P Preferred Stock (PFF)
  - Tracks the S&P U.S. Preferred Stock Index
    - The index is comprised of U.S. traded preferred stocks that meet criteria relating to minimum size, liquidity, exchange listing and time to maturity. The index is calculated with a modified capitalization weighted scheme, with modifications being made to index shares to prevent single issuer concentration and improve index liquidity. The index is rebalanced on a quarterly basis.
  - Morningstar Data Quick Notes
    - 12-mo yield 7.32%
    - Expense Ratio 48 bps; \$6.2B AUM; 41% Turnover
    - 3-yr Return 6.81; 3-yr Standard Deviation 33.28

# Preferred Stock (PFF) 4 yr Vs. S&P 500



# Preferred Stock ETFs

- PowerShares Preferred (PGX)
  - BOA Merrill Lynch Core Fixed Rate Preferred Securities Index
    - The Index is designed to replicate the total return of a diversified group of investment-grade preferred securities. (Securities must be investment-grade, based on an average of three leading ratings agencies: Moody's, S&P and Fitch). The Index is rebalanced on a monthly basis.
  - Morningstar Data Quick Notes
    - 12-mo yield 6.72%
    - Expense Ratio 50 bps; \$1.3B AUM; 34% Turnover
    - No 3-yr / 5-yr data available Inception Date 1/31/08
- PowerShares also offers a Financial Preferred ETF (PGF)
  - Preferred Stock of 30 Financial Institutions, Yields 7.08%,
  - 6.1B AUM
  - Wells Fargo Hybrid and Preferred Securities Aggregate Index

# Preferred Stock ETFs

- SPDR Wells Fargo Preferred Stock (PSK)
  - Wells Fargo Hybrid and Preferred Securities Aggregate Index
    - A modified market capitalization weighted index composed of preferred stock and securities that are functionally equivalent to preferred stock including, but not limited to, depositary preferred securities, perpetual subordinated debt and certain securities issued by banks and other financial institutions that are eligible for capital treatment with respect to such instruments akin to that received for issuance of straight preferred stock.
  - Morningstar Data Quick Notes
    - 12-mo yield 6.01%
    - Expense Ratio 45 bps; \$102M AUM; 22% Turnover
    - No 3-yr / 5-yr data available Inception Date 9/16/2009

# Top 3 Preferred ETFs Vs. S&P 500 (1Yr)



# International Equity Income

- SPDR S&P International Dividend ETF (DWX)
  - S&P International Dividends Opportunity Index
    - Seek to ensure diversified exposure, so a number of weighting criteria are applied to each specific index at each semi-annual rebalancing. The indices in this series all aim to maximize their corresponding dividend yield through optimization.
- Morningstar Data Quick Notes
  - Category - Foreign Large Value
  - Note: 10% Giant, 30% Large, 58% Mid, 0% Small Cap
  - Currently 101 companies, 12-mo yield 4.23%
  - Expense Ratio 45 bps; \$342M AUM; 131% Turnover
  - Inception Date 2/12/08 Index 5-yr Standard Deviation 27

# International Equity Income

- iShares Dow Jones Int'l Select Dividend (IDV)
  - Dow Jones World Developed-Ex U.S. Index
    - Top 100 dividend payers based with country and company weightings. Rebalanced Annually.
  - Morningstar Data Quick Notes
    - Category - Foreign Large Value
    - Note: 34% Giant, 32% Large, 31% Mid, 1% Small Cap
    - Currently 99 companies, 12-mo yield 3.94%
    - Expense Ratio 50 bps; \$358M AUM; 62% Turnover
    - Inception Date 6/11/2007
    - 3-Yr Return -5.17 Standard Deviation 31.93

# International Equity Income

- WisdomTree DEFA (DWM)
  - WisdomTree DEFA Index
    - a fundamentally weighted Index that measures the performance of dividend-paying companies in the industrialized world, excluding Canada and the United States, that pay regular cash dividends and that meet other liquidity and capitalization requirements.
  - Morningstar Data Quick Notes
    - Category - Foreign Large Value
    - Note: 54% Giant, 28% Large, 14% Mid, 2% Small Cap
    - Currently 637 companies, 12-mo yield 3.24%
    - Expense Ratio 48 bps; \$418M AUM; 97% Turnover
    - Inception Date 6/16/2006
    - 3-Yr Return -8.3 Standard Deviation 26.5

# Equity Portfolio Adjustments

- Our goal is to keep risk the same while increasing yield. In our portfolio we are willing to have a value tilt in domestic/international large cap and take on a small percentage of preferred stock to boost yield.
- From the data provided on previous slides we decided to add the following ETFs to the portfolio:
  - 4% SDY - Large Cap S&P Domestic Dividend focused ETF
  - 8% DWX - Intl S&P Dividend focused ETF
  - 4% PFF - S&P Preferred Stock

# Adding SDY, DWX and PFF

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# 5 Year Look Back

	Before	After
Yield	2.77%	3.2%
Return (Annualized)	5.78%	6.08%
Standard Deviation	9.69	10.12
Sharpe Ratio	.39	.41

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