

Global Income Strategies for Australian Investors

At a Glance

- A growing number of Australian investors are seeking to build portfolios generating a reliable income stream.
- High yield investments offer a variety of benefits, including the potential for more stable returns in periods of heightened volatility.
- In a low interest rate environment, it can be difficult for Australian investors to create a truly diversified yield-oriented portfolio within the confines of the local market.
- By diversifying offshore, yield-oriented investors may be able to reduce risk through more effective diversification, while accessing new income opportunities.
- Global income ETFs are an administratively simple and cost-effective vehicle for high-yield international investments.

Following the market volatility of recent years, Australian investors have shown a strong appetite for yield-oriented investments. Yet in a low-interest rate environment, high-yielding assets have become more difficult to find onshore. An exchange traded fund (ETF) can be an effective way to benefit from the income-generating potential of equity markets around the world, creating a reliable and diversified income stream through a single investment.

The Drive for Yield

Since the global financial crisis, investors around the world have been increasingly attracted to yield and dividend based strategies — and nowhere more so than in Australia. Our ageing population, combined with the seemingly unstoppable popularity of self-managed super funds (SMSFs) as an investment vehicle, has seen a growing number of Australian investors seeking to build portfolios generating a reliable income stream.

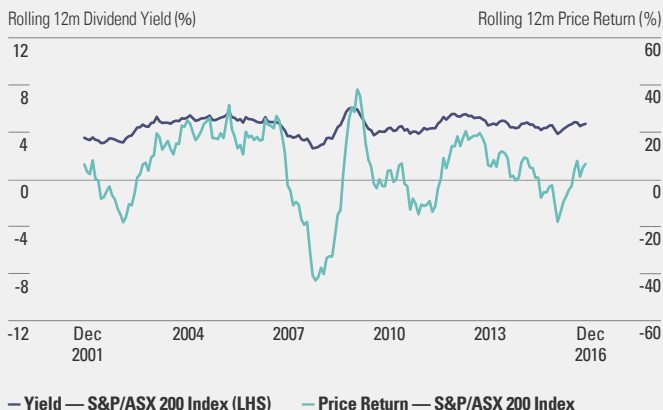
Yet in a low-interest rate environment, it has also become increasingly difficult to find high-yielding assets onshore, especially while maintaining meaningful levels of diversification. Cash and bond yields have remained low, and corporate earnings growth is still below the long-term trend, limiting dividend growth. Meanwhile, yield opportunities in the Australian share market remain highly concentrated in a small number of sectors dominated by a few large companies, giving rise to high levels of concentration risk.

Fortunately, there is a solution. By diversifying offshore through a global income ETF, Australian investors can tap into the income-generating potential of some of the world's most stable and profitable companies, while reducing risk through effective diversification across companies, sectors, markets, and regional economic cycles.

The Benefits of a High-Yield Strategy

Australians have always been more inclined to invest for income than many of our global peers, in part because of the tax benefits of our dividend franking regime. However, the benefits of investing for yield extend well beyond any potential tax advantages. In particular, a yield oriented approach may allow risk-conscious investors to achieve more stable returns without sacrificing overall performance.

Figure 1: The Stability of Price Return Versus Stability of Income (Including Reinvestment)



Source: State Street Global Advisors (SSGA) and S&P, as at 31 December 2016.

Stability

Over the 10 years to 31 December 2016, Australia’s S&P/ASX 200 Index delivered an annualised total return of 4.53% pa. 100% of this return (4.53% pa) came from reinvested dividends.¹ Dividend income is not only an essential component of overall share returns; it also tends to be more predictable and sustainable than capital growth, simply because returns from dividends have historically been less volatile than share price movements.

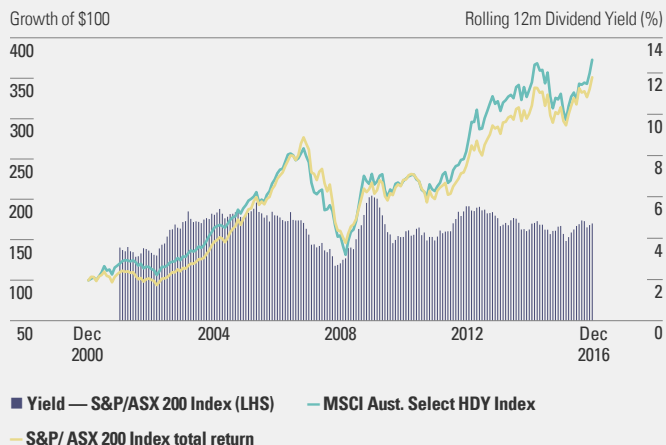
Figure 1 compares the rolling one-year return from capital growth across S&P/ASX 200 companies with their rolling one-year dividend yield. While the unfranked dividend yield moves through a relatively small range, from just 3% to 6%, the rolling one-year price return ranges from almost 40% on the upside to below -40% on the downside.

The reason for this difference is clear: managers of blue chip companies place a high premium on maintaining and enhancing dividend payments, delivering the stability they know investors seek. Companies with strong cash flows are well positioned to manage their balance sheets for dividend stability, whereas share price fluctuations are both vulnerable to outside influences and largely beyond their control.

Performance

There is also good evidence to suggest that a high-yield, value oriented portfolio can match or outpace broader market performance, particularly in periods of heightened volatility. Figure 2 shows the cumulative return from a \$100 investment in Australian shares, together with the rolling one year dividend yield. It also shows the return from a portfolio of high yield securities, drawn from the MSCI High Dividend Yield (HDY) Index.

Figure 2: Income and Price Growth of \$100 Invested in Australian Shares

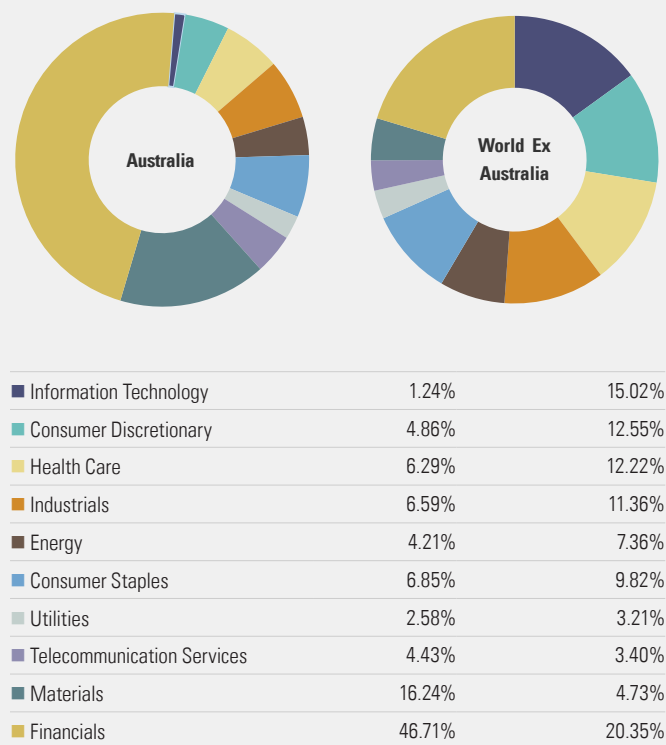


Source: SSGA and S&P, as at 31 December 2016.

It is not possible to invest directly in an index. Index performance does not reflect charges and expenses associated with the fund or brokerage commissions associated with buying and selling a fund.

It’s clear that regular income has been a significant component of the total return from equities, and is considerably more stable than price performance. More significantly, the high yield alternatives delivered equivalent or stronger overall returns than the broader market.

Figure 3: Concentration Risk in the Australian Market
S&P/ASX 200 Index S&P World Ex Australia Index



Source: FactSet, S&P and SSGA, as at 31 December 2016.

Is It Time to Diversify Offshore?

While the benefits of investing for yield are clear, it can be difficult for Australian investors to create a truly diversified, yield-oriented equity portfolio within the confines of the local market.

The Australian equity market is heavily weighted towards just a few sectors – primarily materials and financials (Figure 3). Together, these two sectors make up almost two-thirds of the Australian market by value, compared to less than 25% of global markets outside Australia. Meanwhile, higher yield sectors such as utilities, telecommunications and financials are dominated by a few large companies, increasing the concentration risk of purely domestic portfolios.

Why Diversify Offshore?

While international high yield investments do not carry franking credits, they may offer investors a range of other benefits that have the potential to significantly enhance overall portfolio performance. They include the ability to:

- Access new companies and sectors with different economic and growth profiles.
- Reduce portfolio risk through more effective diversification.
- Resolve concentration risk.
- Benefit from more attractive equity valuations in undervalued markets.
- Benefit from structural trends across the global economy, including growth in emerging markets.

Can Australia Continue to Outperform?

Diversifying offshore also helps investors guard against the risk that Australia's recent, outstanding economic performance may not be sustained in the longer term.

Over recent years the Australian economy has been highly resilient, underpinned by strong demand for resources and the strength of the Australian banking system. This has resulted in low unemployment, a high dollar and a generally healthy economy, providing a comparatively strong platform for asset price growth.

As we look forward, however, we see the US, European and broader global economies strengthening, while the Australian economy is affected by a range of concerns, including:

- The slowing rate of demand for resources from China.
- Record property prices.
- More fully valued banking stocks.
- Constraints on consumer spending at a time of increasing government austerity.

Considerations like these suggest that the time could be right for yield-oriented investors to consider reducing risk and accessing new income opportunities by diversifying offshore.

The Benefits of Diversifying Offshore with SPDR ETFs

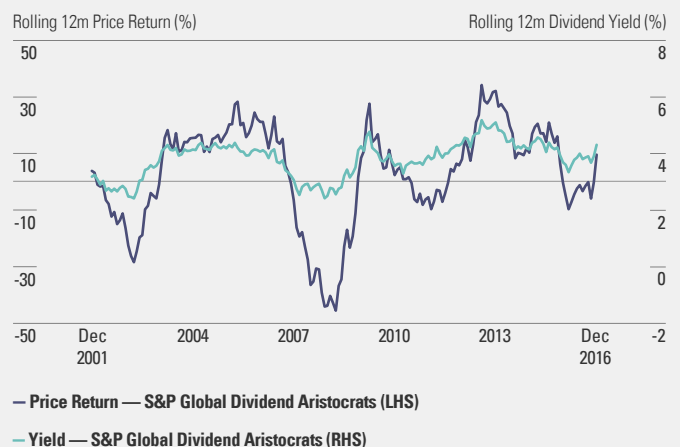
- Diversified international exposure
- The simplicity and transparency of an investment in Australian shares
- The ability to take advantage of high yield investments from around the world through a single investment
- The ability to adjust asset allocations, increase or decrease exposure and rebalance portfolios quickly and easily
- Less need to research, select, monitor and trade shares across unfamiliar markets

Why Invest in High Dividend Global Equities?

While Australian shares have traditionally offered higher yields than overseas equities, it is now possible to access significant income opportunities in markets across the globe. Figure 4 shows the rolling one-year price return and dividend yield for a portfolio of high-yield global shares, based on the S&P Global Dividend Aristocrats Index – an index specifically designed to capture the performance of high yield companies with a history of maintaining or increasing dividends.

As in the Australian market, this portfolio delivers a highly stable dividend yield (ranging from 2.5% to 5% pa, but typically around 3.5% pa) despite wide share price variations (ranging from almost 35% on the upside to below -45% on the downside). In a 10 year total annualised return of 3.08% to 31 December 2016, all of the return (3.82% pa) comes from reinvested dividends, the price-only return was -0.74%.²

Figure 4: The Stability of Dividend Income Versus Growth in Global Shares (Including Reinvestment)



Source: SSGA and S&P, as at 31 December 2016.

Both in Australia and globally, high quality dividend-based investment strategies have historically participated in many of the market upswings, while offering elements of downside protection in turbulent times. This profile has resulted in strong risk-adjusted returns over the last decade, particularly when viewed in the context of a poor decade for broad market developed equities. An often overlooked feature of dividend investing is the element of quality that is introduced to a portfolio, particularly if the strategy moves beyond pure yield and focuses on companies that have a consistent record of growing dividends as well. A company that has shown an ability to consistently grow its dividend over time often indicates that it operates in a relatively stable, non-cyclical industry.

It also suggests strong corporate governance with a management team committed to delivering value to its shareholders and disciplined in its use of capital. Alternative uses of capital include investing for growth, making acquisitions or buying back stock – all strategies which may deliver significant shareholder value over time, but can also be impacted by the vagaries of the economic cycle and the ability of management to execute on its plans.

The Benefits of International Diversification with ETFs

Despite the potential benefits of diversifying offshore, many Australian investors have a minimal allocation to international equities. For example, ATO data shows that self-managed super funds (SMSFs) invest an average of only 0.3% of their capital in overseas shares, with the bulk of their assets in cash (26%) and Australian equities (30%).³ Underpinning this home bias are a range of administrative and financial barriers that have traditionally frequently discouraged investors from accessing overseas markets. Fortunately, investors can now take advantage of cost-effective investment options that overcome many or all of these barriers, while still maintaining a focus on yield. In particular, global income ETFs offer a cost-effective and easily administered vehicle for offshore diversification, without the complexities of a direct investment.

¹ SSGA and S&P, December 2016.

² FactSet, S&P and SSGA, December 2016.

³ Australian Taxation Office, Self-managed super fund statistical report, June 2016.

Figure 5: Simplifying International Investments with ETFs

Issue	Description	How ETFs Can Help
Research and Stock Selection	Researching and selecting investments on unfamiliar markets can be challenging.	ETFs give investors instant, cost-effective access to a diversified international portfolio without the need to become international market experts.
Administrative Complexity	Direct international investments can be complex and time-consuming to manage.	ETFs can be bought and sold in moments on the ASX, just like Australian equities.
Tax	Direct investments can give rise to complex tax issues across jurisdictions.	With Australian listed international ETFs, challenges such as having to complete US tax forms is reduced as the ETF issuer handles these for the unit holders.
Foreign Exchange	Currency fluctuations can have a significant impact on international investments — both positive and negative.	Investors can limit currency risk by investing in a hedged ETF or use an unhedged investment to take advantage of the potential benefits of any fall in the value of the Australian dollar.
Management Costs	International managed investments typically have significantly higher management costs than their domestically-focused peers.	ETFs offer low management costs both on and offshore.
Yield	Income-oriented investors have traditionally favoured domestic equities for their relatively high, franked dividends.	Investors can now use ETFs to access diversified international portfolios designed to deliver a potential higher level of income than domestic portfolio, although without the benefits of dividend franking.

Figure 6: SPDR International ETFs Providing Global Income for Australian Investors

Fund	ASX Code	Benchmark	Description	Management Costs (%)
SPDR® S&P® Global Dividend Fund	WDIV	S&P Global Dividend Aristocrats Index	Tracks an index representing high yielding companies from the S&P Global Broad Market. Index with a history of stable or increasing dividends.	0.50
SPDR® Dow Jones® Global Real Estate Fund	DJRE	Dow Jones Global Select Real Estate Securities Index	Tracks an index representing global REITs and real estate operating companies.	0.50

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ETFs trade like stocks, are subject to investment risk, fluctuate in market value and may trade at prices above or below the ETF's net asset value. ETFs typically invest by sampling an index, holding a range of securities that, in the aggregate, approximates the full index in terms of key risk factors and other characteristics. This may cause the fund to experience tracking errors relative to performance of the index.

Investing involves risk including the risk of loss of principal. Diversification does not ensure a profit or guarantee against loss. Sector ETF products are also subject to sector risk and non-diversification risk, which generally results in greater price fluctuations than the overall market.

Risks associated with equity investing include stock values which may fluctuate in response to the activities of individual companies and general market and economic conditions.

Investing in foreign domiciled securities may involve risk of capital loss from unfavorable fluctuation in currency values, withholding taxes, from differences in generally accepted accounting principles or from economic or political instability in other nations.

Investments in emerging or developing markets may be more volatile and less liquid than investing in developed markets and may involve exposure to economic structures that are generally less diverse and mature and to political systems which have less stability than those of more developed countries.

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