FOUR ETF DIVIDEND TRADING STRATEGIES

By Daryl Guppy

ETFs offer a different method for trading markets. They reduce risk as they are beta neutral for the index they track. They generally match or track the exact performance of the underlying index. They offer steady reward via the distribution of consolidated dividends delivered by each of the stocks in the underlying index.

This week we examine the strategy construction for the dividend hop. There are 3 sub-strategies. They are:

Strategy 1

Dividend trading – index ETF

Strategy 2

Dividend hop – multi index ETF

Strategy 3

Dividend hop - ETF sector Index

Strategy 4

Dividend aggregation – specialist ETF

These first three strategies are designed as a trading method to skim, or lift, the dividends payable on all the stocks that make up the underlying index. In a rising market it delivers a capital return and a dividend return. In a falling market the risk is greater because the strategy may incur a capital loss.

Initiation of the strategy will depend on the direction and nature of the trend prior to the entry and exit point. The ideal situation is a rising trend or at worst, a sideways trend. This ensures that the risk to capital is reduced, and the dividend yield is captured completely.

ETF dividends have five interesting features. They are:

- The first is that the ETF gathers all the dividends paid at different times during the year by each of the underlying companies in the index. These dividends are consolidated into a single payment made twice a year. In some instances, with international ETFs, the payments are made every quarter.
- The second feature impacts on trend behaviour when the ETF goes ex-dividend. Unlike trading in the underlying company, for instance a large bank, there is no significant price reaction when the stock goes ex-dividend. If we trade a dividend in an individual stock then the risk is a substantial price drop – and a capital loss – when the stock goes ex-dividend. This behaviour is made worse in a bear market where the price fall following the ex-dividend date can be substantial. This more than wipes out the value of the dividend.

  When the ETF goes ex-dividend this is usually a very small impact in price. The pre-existing trend continues to prevail. If this trend is up, or sideways, it means there is less risk in terms of a reduction of capital.
- The third feature is that the performance of the index, and hence the ETF, is not dependent upon the performance of an individual company. This means that the existing trend behaviour of the market is more powerful than the individual behaviour of any stocks as it goes ex-dividend. As the ETF ex-dividend dates do not coincide with any particular individual event, there is a reduced impact on trend behaviour due to the ETF going ex-dividend. The

market simply does not care and takes no notice. With an individual stock, the market does care, and it reacts accordingly.

- The fourth feature is essential for many of the trading strategies in these notes. Buying and selling an ETF incurs the normal brokerage rate. I pay $33.00 for every ETF trade. Unlike managed funds, there are no exit fees or penalties and the ETF is traded under the same conditions as an ordinary stock.

- The ETF exists in a made market. The market maker must stand in the market in the absence of any other trades and the degree of spread is limited by regulation. An ETF chart may look 'spotty' but this does not limit the ability to trade the ETF.

Dividend stripping is the strategy of buying a stock a few days prior to the dividend date, then selling it as soon as it goes ex-dividend. The objective is to simply take the dividend. In many countries this method is subjected to an additional level of taxation. The implementation of dividend stripping-style strategies must always take this taxation impact into account.

Strategy 1 - Dividend trading – index ETF

This strategy is designed to reduce risk and collect the dividend. It is an income stream model. The risk is reduced by the trending behaviour of the ETF and the underlying index. Remember, the ex-dividend date does not have a dramatic impact on the underlying trend or price, so capital risk is reduced.

This is more effective than trading dividends in individual shares. If we tried to track the individual stocks in the XJO 200 index then we have to track 400 dividend payments a year. The consolidation of dividend payments into 2 dividends by the ETF reduces the complexity of trading. Dividend dates are around June 24 and December 21 each year.

In this example we use a 40 trading day holding period. Trades completed inside the 40 day period incur a penalty tax because the 40 day period include the ex-dividend date. Depending on a jurisdiction, the minimum holding period may be larger or smaller.

There are three potential entry points. They are shown on the chart extracts. The first enters around 40 day prior to the ex-dividend date and exits on the day of ex-dividend. This is a very defensive strategy. If the Index begins to trend downwards the trade can be abandoned with minimum capital loss. The dividend payment is lost, but capital is preserved. Exit immediately after ex-dividend is a strategy applied to individual stocks because the ex-dividend behaviour can be dramatic. There is a lower probability of this with the ETF.

The second entry point is balanced either side of the ex-dividend day. The purpose is to ride an existing trend, but this strategy does not assume the rising trend will continue for an indefinite period after the ex-dividend date. This strategy has moderate risk because trending behaviour before the ex-dividend date is captured and this behaviour does not have to continue for an extended period after the ex-dividend date.

The third entry point is to enter just prior to the ex-dividend day and hold the ETF for the required minimum period. The advantage of this entry is that the pre-existing trend is well established and there is a high probability it will continue. This is the strategy with the highest risk because it relies entirely on future trend continuation.

This type of dividend collection adds alpha to the ETF. The ETF capital performance has a beta of 1. If the market increases 20%, then the capital value of the ETF also increases 20%. Alpha is a measure of out performance of the market. This is achieved by harvesting the dividends.

Strategy 2 - Dividend hop – multi index ETF

This strategy approach uses the methods applied to trading a single ETF, but it creates a calendar spread using the trading of international listed ETFs. This is

dividend hoping, moving from one dividend payment period to another. The objective is to reap an income return, rather than a capital return. When the strategy is applied it is important to remember the limitations created by any minimum holding periods.

	Dividend	Dividend	Dividend	Dividend	Dividend
ijp	27/12/2007		26/06/2008		27/12/2008
iem	27/12/2007		26/06/2008		27/12/2008
ioo	27/12/2007		26/06/2008		27/12/2008
ive	27/12/2007		26/06/2008		27/12/2008
izz	27/12/2007		26/06/2008		27/12/2008
ihk	27/12/2007		26/06/2008		27/12/2008
iko	27/12/2007		26/06/2008		27/12/2008
isg	27/12/2007		26/06/2008		27/12/2008
itw	27/12/2007		26/06/2008		27/12/2008
stw	21/12/2007		24/06/2008		21/12/2008
ivv	27/12/2007	26/03/2008	26/06/2008	26/09/2008	27/12/2008
ijh	27/12/2007	26/03/2008	26/06/2008	26/09/2008	27/12/2008
ijr	27/12/2007	26/03/2008	26/06/2008	26/09/2008	27/12/2008
iru	27/12/2007	26/03/2008	26/06/2008	26/09/2008	27/12/2008

The spreadsheet extract shows the ex-dividend dates for 14 ETFs. In this particular market the majority of dividend dates are December 27 and June 26. The last four ETFS are US based, and they have four dividend distributions a year.

Implementation of the strategy starts with an assessment of the dividend yield that applies to each of the ETFS. This is most difficult in period 1, period 3 and period 5, as there are 14 ETFs that go ex-dividend on the same date. The objective is to identify the ETF with the highest dividend yield. This type of information is aggregated in the www.ishares.com website, or by independent providers such as www.XTF.com .

For the purposes of this example, we will assume that the Hang Seng Index ETF trading is IHK which has the highest dividend yield for the period 1. It also has the best trend behaviour and meets the conditions for entry that we would apply if we were trading a single ETF as discussed in strategy 1. The trade is entered and exited outside of the minimum required holding period. It captures capital gain and a dividend bonus.

Period 1	Period 2	Period 3	Period 4	Period 5
27/12/2007	26/03/2008	26/06/2008	26/09/2008	27/12/2008
IHK	IRU	STW	IVV	IJP
Hong Kong	USA	Australia	USA	Japan

Moving out of December we go to the next ETF dividend period in March. This applies to the ETFs covering the US market. Of these, in this example, the IRU ETF which covers the Russell 2000 Index has the best dividend yield and trading characteristics. This dividend trading strategy 'hops' to the next most profitable ETF from a dividend yield perspective.

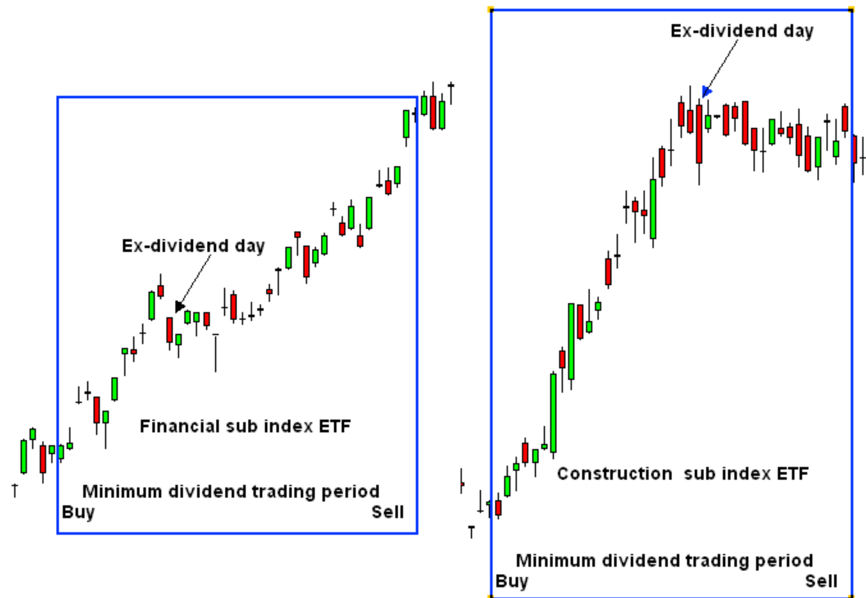
In the third period the trade hops to the StreetTracks ETF, STW which covers the Australian market. The fourth period sees a hop to IVV which captures the dividend return from the S&P 500. The fifth period hops to the dividend yield from Japan.

Each trade captures the ETF price activity and capital gain, and the dividend yield from the most successful individual ETF. These four trades capture capital gain and dividend yield generated by the underlying markets. These trades are all done in a single currency. The S&P ETF is quoted in Australian dollars on the Australian stock exchange, and in Singapore dollars on the Singapore stock exchange. Yield calculations are based on a single currency.

Strategy 3 - Dividend hop - ETF sector Index

This strategy is simply an application of the international Index strategy applied to ETFs covering individual subsectors in either your home market, or the international market. The key concept is the same – it's a calendar spread designed to move into and out of trades as each successive dividend is declared and distributed. The strategy takes the dividends from the top performing sector for each period.

This is not a calendar spread. All the sub-index ETFs go ex-dividend at the same time. When each dividend period is due, an assessment is made to locate the best yield in the sub-index ETFs. This is the same strategy as applied to trading an individual ETF index, but the selection choice is wider. This captures sector alpha when compared to market index beta. Outperforming sectors will often also deliver capital gain and well as dividend income.



Our ETF strategy objective is to use the ETF to obtain alpha performance. The ETF provides a low risk and steady reward model for investment. The risk is the same as the market risk. The reward is also the same as the market .

Strategy 4 - Dividend aggregation - ETF specialist Index

The ETF landscape has continued to develop. There are now a number of specialist ETFs designed to capture and distribute dividends on a monthly basis.

Amount	Frk%	ExDate	PayDate
Most Recent			
20.05	78.33	02-Aug-2016	17-Aug-2016
18.13	69.85	01-Jul-2016	18-Jul-2016
20.58	69.12	01-Jun-2016	16-Jun-2016
20.43	77.78	02-May-2016	17-May-2016
20.48	64.38	01-Apr-2016	15-Apr-2016
20.17	64.22	01-Mar-2016	16-Mar-2016
21.22	74.78	01-Feb-2016	16-Feb-2016
21.21	87.82	04-Jan-2016	19-Jan-2016
21.59	57.32	01-Dec-2015	16-Dec-2015
21.59	72.61	02-Nov-2015	18-Nov-2015
21.54	78.07	01-Oct-2015	19-Oct-2015
21.10	38.61	01-Sep-2015	16-Sep-2015
21.33	77.64	04-Aug-2015	19-Aug-2015
21.62	55.82	01-Jul-2015	20-Jul-2015
21.71	57.32	01-Jun-2015	17-Jun-2015
22.12	73.71	01-May-2015	18-May-2015
22.17	68.18	01-Apr-2015	20-Apr-2015
22.43	56.92	02-Mar-2015	17-Mar-2015
22.94	93.71	02-Feb-2015	17-Feb-2015
22.72	91.71	02-Jan-2015	19-Jan-2015
23.50	0.00	01-Dec-2014	19-Dec-2014

This is not a trading option. It is a longer term investment approach designed to collect yield. Current yield is around 1% per month. That's 12% per year which is much better than cash rates. Yield of course depends on the price paid for entry into the ETF. Investors may also collect a capital gain through normal trading approaches to the trend activity in the ETF although for the past year many of these have been trapped in a sideways trading band about 5% wide.