# Three innovative new ways to gain an equity-based income

Three relatively new products can help deliver total shareholder returns, says David C Stevenson

David C Stevenson

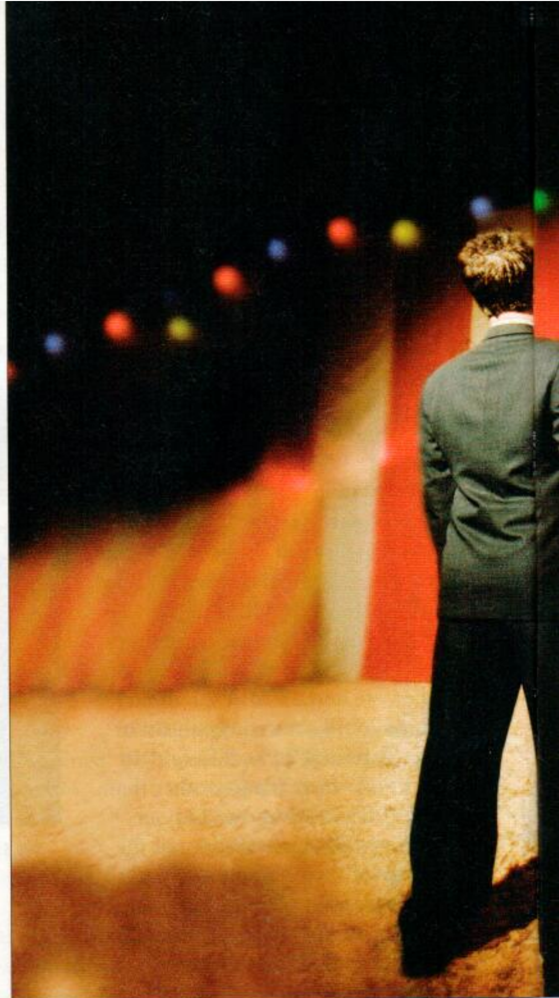
This week I want to return to the recurring theme of building a robust, sustainable equity-based income, highlighting three relatively new products that I think could hit the sweet spot. First though, I want to emphasise that investors need to focus on funds that deliver total shareholder returns. This sounds like a complicated term, but it reminds us that we can make a return in three different ways. The first is from receiving a regular dividend. Next, investors can also receive a capital gain, ie, the share price increases in value. Last but not least you can also reinvest that dividend back into the underlying shares.

In fund terms this is achieved in one of two ways – in traditional unit trusts you can invest in an accumulation version of the fund, whereas in exchange traded products you might invest in a total returns version of an index tracker. Both achieve the same end purpose – they reinvest that income stream. This can strike some income-hungry older investors as a bizarre idea – "but I need the income so why accumulate and reinvest?". The answer to this very much depends on your tax status. Remember that in the 2014/2015 tax year you are allowed to sell down assets and generate a profit of £11,000 before you pay any tax at all (anything over £11,000 has capital gains tax (CGT) of between 18% and 28%). Let's assume, for argument's sake, that you have a £200,000 capital pot with an average income yield of 5%. If you already receive an income from work, those dividends taken as a distribution will attract your marginal tax rate in full (assuming you have no unused tax allowances). But if you use an accumulation version of a fund or product and then sell down units equivalent to that 5%, you'd entirely escape capital gains tax. For wealthier investors the logic is even more compelling, especially those paying tax at 40% or 45%.

However, those focused on equity income need to diversify their investments. Too many funds dedicated to equity income invest in a narrow bunch of FTSE 100 based assets with a relatively simple strategy – focus on dividends and then make sure those dividends are growing over time, backed by a decent business. It's an eminently tried and trusted idea. But some interesting new ideas have begun to emerge, especially around combining rules-driven investing strategies with a focus on absolute returns. One in particular, from a partnership between a hedge fund – Hinde Capital – and French bank Societe Generale, looks to add a number of innovative twists on this idea.

**"Those focused on equity income need to diversify"**

Last week saw the launch of the **SG Hinde UK Dynamic Equity ETN (LSE: HALF)**. This new exchange traded note (it's not a fund but a note, where the counterparty is SocGen itself) shares many of the same characteristics of what's called the smart beta movement – passive funds that use various rules to narrow down the universe of stocks in an index. The ETN uses measures such as the dividend yield, the timing of dividend payments, as well as metrics based around the balance sheet and relative stock performance to identify its stocks within the universe of the FTSE 350 (the FTSE 100 and the mid-cap 250). This ETN takes these fairly standard ideas and adds a new twist or two. They reckon that equity income investors need to capture more of the upside from equities and less of the downside. In their new dividend-focused ETN they do this in two ways: on the upside, the portfolio is very concentrated on just 20 names (ten from the FTSE 100 and ten from the FTSE 250), equally weighted while the index is rebalanced quarterly. On the downside those systematic rules mean that exposure to certain sectors is capped. But the big addition is that the portfolio is 50% hedged on the downside, which helps explain why the fees on this product are a bit pricier than some peers, at 1.3% per annum. This hedging won't do away with all losses in every market but it will (hopefully) dampen down volatility, while a backtest suggests that returns would have been around 12% per annum on average over the last decade. This ETN is a total returns product, which means investors can make use of that CGT allowance I mentioned earlier.


These new products will lp

Another very recent launch looks for income in an entirely different part of the world and stockmarket sector. A new index tracker from ETF Securities called **ETFS US Energy Infrastructure MLP GO UCITS ETF (LSE: MLPX)** was launched just last week. The product tracks something called the Solactive US Energy Infrastructure MLP Index TR, which follows the share price of Master Limited Partnerships (MLPs). I have written before about these fascinating creatures – they are like real estate investment trusts (REITs) in that they own equities in partnerships that invest in actual