



Variety the spice of dividends

Banks' bonds and shares represent attractive options but they're not the only high-yielding game in town, writes DAVID POTTS.

THE next interest-rate rise has been put off to the never-never but there's help for savers from an unexpected quarter. The sharemarket. Not only are there blue-chip stocks that are paying generous, and rising, dividends but it's also home to other safer high-yielding investments.

Term deposits pay up to 7.25 per cent but you have to commit to five years.

Since the best one-year rate is 6.6 per cent from RaboBank and the Bank of Cyprus, according to InfoChoice, what amounts to only two more rate rises built in is not a very generous reward for locking your money away for five years.

It's true term deposits come with a government guarantee that, incidentally, expires in October, though the chances are it will be extended, but you can boost your return with bank bonds, which you can buy and sell in the sharemarket.

You could even argue they come with less risk than a term deposit if you take it as granted, considering the Reserve Bank wouldn't have it any other way, that a bank will never be allowed to default on its savers.

Because the interest is floating rather than fixed, you can't make a wrong call about where rates might be going. If they go up, all the better because so will your return.

For example, the Commonwealth Bank's four-year bond, which trades in the sharemarket under the code CBAHA, pays 1.05 per cent more than the money market's 90-day rate.

Plus there's the bonus that it's trading for more than it's worth.

With inflation threatening to rear up any time, it's also worth bearing in mind that a floating-rate security affords protection against it.

That's because the Reserve Bank would be

lifting rates to fight it, so the bonds would never fall behind as, say, a five-year term deposit might.

Then again, you could go the whole hog and buy inflation-indexed bonds from the banks.

You can only pick these up from fixed-interest brokers. They offer a real yield of 4 per cent a year, making them ideal for super funds, the managing director of FIIG Securities, Jim Stening, says.

Then there are shares in the banks themselves. Unlike bonds or term deposits, these come with a handy tax break as well.

Dividends that are franked have a 30 per cent tax credit, irrespective of your income.

In fact, the tax credit can be a cash refund for taxpayers in the zero or 15 per cent tax brackets.

The rule of thumb is that franking adds another 43 per cent to the dividend yield before tax kicks in.

So, for example, the dividend paid by ANZ would yield 5.5 per cent if you'd bought its shares on Friday.

After franking, the true yield is 7.9 per cent before you're taxed. On a marginal rate of zero, the after-tax yield would also be 7.9 per cent, compared with 6.11 per cent for a three-year term deposit at the same bank.

Surely you're not surprised that the banks pay their shareholders more than their depositors?

Mind you, shareholders only get paid twice a year and, as they discovered after the global financial crisis, dividends can suddenly drop.

Still, bank stocks are unusually cheap considering the dividends they're paying.

Normally, because they can't promise any growth, savings accounts will have a higher yield than bank shares.

But at the moment it's the other way around.

Take CBA. Its best term-deposit rate is 6.4 per cent for five years. But after franking is taken into account, its shares are yielding about 8.5 per cent. And for existing shareholders that'll get bigger as profits grow.

The trouble is that, unlike a term deposit, you



also have to assess the bank itself, not to mention the horror of seeing your capital erode when the share price drops.

You have to decide which one will be the most profitable over time and so the most likely to pay a higher dividend.

Another missing high yielder is West Australian Newspapers which has been a good dividend payer in the past, and at its current price would be yielding 8.7 per cent or 12.4 per cent franked. But its reverse pike backflip takeover of Seven will saddle it with a huge debt despite a large rights issue.

The market has heavily marked down its shares, suggesting it doubts the dividend reward will remain so high. But just chasing dividend yields on bank stocks has its dangers, too.

While the banks might be making record profits there's not much further they can go from here without another credit boom.

If they fall out of favour with the market, what you gain from the dividend yield could be more than lost as the price drops.

That's why you need to diversify, and not just go by the dividend.

Russell runs a fund listed on the stock exchange that aims to pay a dividend 1 per cent higher than the best blue-chip shares and, not surprisingly, is proving popular with DIY super funds.

Since its launch nine months ago, the Russell High Dividend Australian Shares Fund (with the ASX code RDV) has attracted \$142 million from investors.

Chasing a single stock for its dividend can be self-defeating, as Telstra shows.

It has the highest yield you could hope from a blue-chip stock at more than 10 per cent or more than 14 per cent after franking. But at what cost? Just think if you'd bought them when they were \$5. Oh, sorry.

Even buying them now, at a price that may well prove to be the bottom, may not be such a good idea, either.

That's because in choosing it you've missed something better.

Such as BHP Billiton. It could never be regarded as a high-yielding stock and, even as we speak, is embarking on a huge share buyback to get rid of its kitty of franking credits rather than pay out a bigger dividend.

And yet, if you'd bought \$10,000 worth of BHP shares 10 years ago when it was trading at \$7.36, not only would you have made a six-fold capital gain, you'd be earning \$750 a year in dividends plus franking credits, a Russell Research study says.

During the past 10 years, Russell Research says the sharemarket returned 8.2 per cent a year, of which only 2.7 per cent came from rising share prices.

With the franking credits, dividends accounted for two-thirds of the return.

"We tell clients it's wrong to focus on the yield," chief executive of research house and fund manager Lincoln, Elio D'Amato, says.

"What determines a good yield is the quality of the business. Look what happened to Babcock and Brown or the property trusts."

The fact is that as a business grows over time so do profits and therefore dividends.

