Zacks
INDEX SERVICES
A Division of Zacks Investment Management

INVESTING IN DIVIDENDS

Semi-Active versus Passive Strategies

Introducing the Zacks Multi-Asset Income Index™

Investing in Dividends

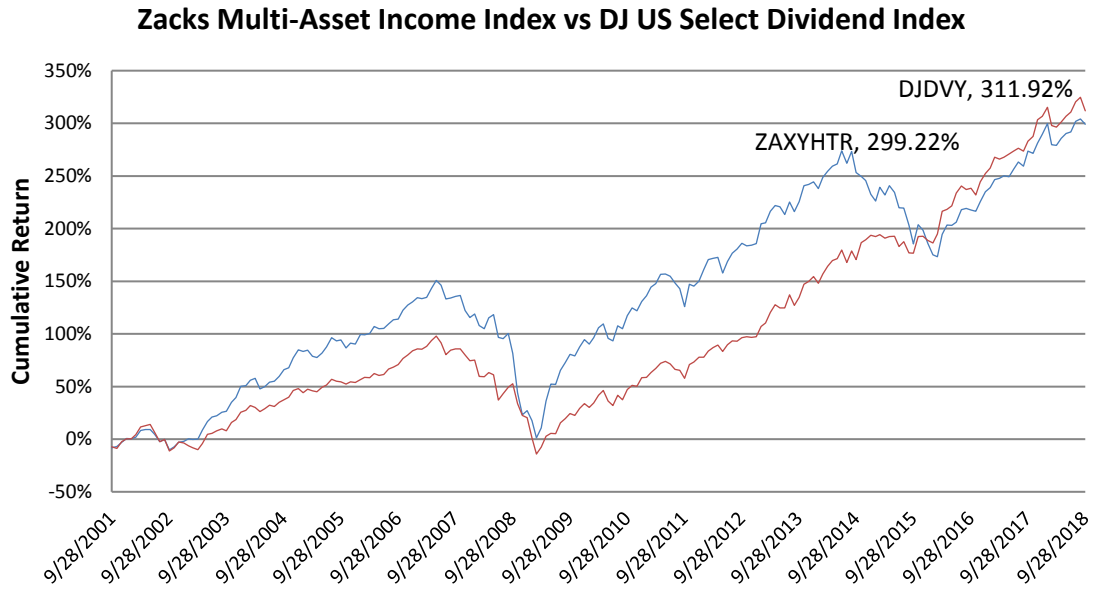
Semi-Active versus Passive Strategies

Introducing the Zacks Multi-Asset Income Index™

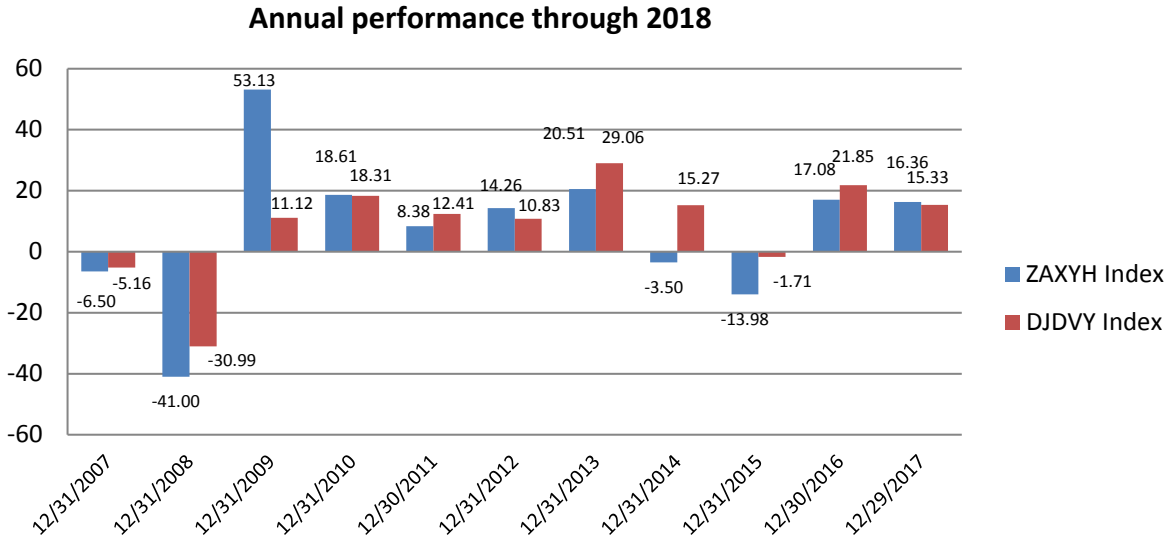
Key Points:

- Zacks Investment Research has created the Zacks Multi-Asset Income Index, the first yield-oriented index to combine equities, preferred stocks, ADRs, REITs, MLPs, and closed-end funds.
- The objective of the Zacks Multi-Asset Income Index is to outperform passive dividend benchmarks using a proprietary model based on dividend growth, dividend sustainability, liquidity, dividend yield, momentum and earnings revisions.
- Through the use of different asset classes as significant portions of the index, the Zacks Multi-Asset Income Index makes use of the low correlation between these asset classes to minimize risk by diversification effect.
- Zacks believes that a strategy focused on high dividend yielding common stocks that have shown sustainable dividend growth and low payout ratios continues to be an effective methodology of generating alpha.
- The Zacks Multi-Asset Income Index utilizes multi-factor model in different sleeves to select securities with sustainable high dividend yield and outperformance potential.
- Zacks has licensed its Multi-Asset Income Index to Invesco Ltd. for the creation of an ETF (Ticker: CVY) that we believe will offer investors a new and significantly better way to invest in income generating securities.

Zacks Multi-Asset Income Index Performance



Source: Bloomberg



Source: Bloomberg

Performance Statistics

	Benchmark	Weight %	Index 3M rtn %	Bench 3M rtn %	Index YTD rtn %	Bench YTD rtn %	Index 2Y rtn %	Bench 2Y rtn %	Index 3Y rtn %	Bench 3Y rtn %	Index 4Y rtn %	Bench 4Y rtn %
Total		100	1.92		2.47		11.97		11.82		3.18	
ADR's	SPADRTR Index	10.14	2	1.94	-11.38	-1.26	7.28	10.04	8.36	8.69	0.18	2.42
CEF's	CEFX Index	10.16	3.05	1.93	1.66	1.35	8.66	8.12	12.52	11.53	6.57	6.99
COM's	DJDVY Index	49.95	2.47	3.08	5.31	4.14	18.66	11.92	17.2	15.25	8.68	11.85
MLP's	AMZ Index	9.66	-1.46	6.57	-3.02	5.9	-1.88	0.51	-13.35	4.43	-23.73	-8.78
Pfd's	SPPREF Index	10.11	0.79	0.1	1.73	1.32	5.64	3.15	7.04	4.84	-1.58	4.65
REIT's	FNERTR Index	9.99	1.78	0.504	6.89	1.78	4.15	3.43	12.28	8.97	6.89	8.68

The statistics is as of 9/28/2018. Periods longer than one year have been annualized.
Source: Bloomberg

Zacks Multi-Asset Income Index™

Zacks Investment Management continues to develop innovative "semi-active" indices whose constituents are chosen based on merit. Zacks has launched the first yield-oriented index that combines common stocks, preferred stocks, master limited partnerships (MLPs), closed-end funds, REITs, and ADRs to maximize yield and minimize risk through diversification.

The objective of the Zacks Multi-Asset Income Index is to select a group of securities with the potential to outperform on a risk-adjusted basis both passive yield-oriented benchmarks and active income fund managers. The Multi-Asset Income Index seeks to:

- Focus on securities that have the potential to grow their income distributions at a sustainable growth rate in the near term.
- Take advantage of the low correlation between different asset classes to provide diversification benefits and minimize both "stock-specific" and "asset-specific" risks.
- Target securities with high dividend yields and liquidity by strategically weighing the index based on those factors.

The Zacks Multi-Asset Income Index contains 125-150 securities. A proprietary quantitative methodology ranks securities in each asset type and selects those securities with the most favorable risk/return characteristics. Strict risk controls maintain broad asset diversification while ensuring that the weights of each security and asset class remain in-line with the model's tolerance levels.

The Zacks Multi-Asset Income Index is a strategic index. It is not designed to replicate the income-yielding market or indicate how the average stock that pays a dividend performed. Rather, the Zacks Multi-Asset Income Index emphasizes constituent selection and asset diversification. The Multi-Asset Income Index is rebalanced quarterly, but index constituents are reviewed weekly for possible dilution or deletion from the index.

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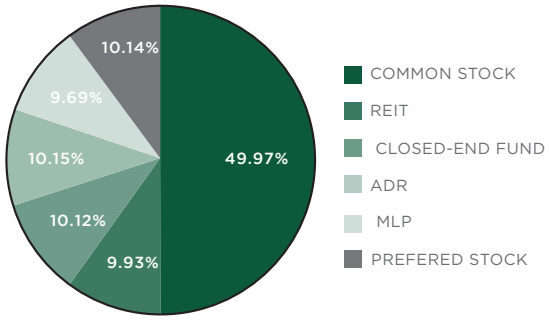
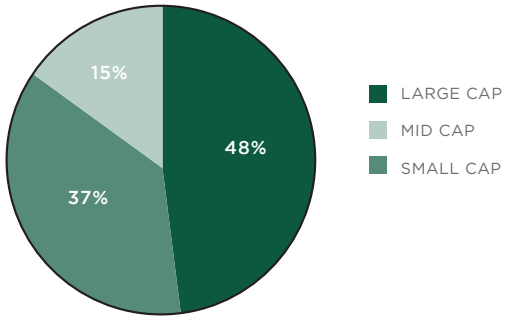
Zacks Multi-Asset Income Index™ Characteristics

Zacks' approach to creating indices is designed to integrate portfolio management techniques and fundamental investment approaches in the constituent selection process. Therefore, deviation from passive market benchmarks or the universe is not only possible but anticipated. Additionally, the inclusion of asset classes such as preferred stocks and MLPs that are not typically included in other equity indices will add to this deviation.

Asset Allocation as of 9/28/2018



Market Capitalization as of 9/28/2018



Source: NYSE, Bloomberg

Sector allocation as of 09/28/2018

GICS Sector	Zacks Multi Asset Income Index	Dow Jones select US dividend Index
Communication Services	1.96	6.12
Consumer Discretionary	12.15	13.21
Energy	14.92	11.94
Financials	29.36	9.06
Funds	10.16	0
Health Care	5.94	4.39
Industrials	5.01	6.03
Information Technology	8.47	5.7
Materials	2.73	6.87
Real Estate	7.34	0
Utilities	1.96	29.31

Source: Bloomberg

Resilience of dividend payments

There has been recent speculation that corporate dividend policy has shifted in some fundamental way reducing the propensity to pay dividends. Fama and French (2001) report that there has been a significant decline in the proportion of firms paying cash dividends from the 1970s to the late 1990s even when firm characteristics are taken into account. However, recent evidence demonstrates that this is not the case and dividends are a highly resilient payout mechanism tied to long-term sustainable earnings, paid by mature companies. Floyd et. al. (2015) report that there has been a strong resurgence of dividend payments starting around 2002. Remarkably dividend payments have been persistent even during the financial crisis of 2007, where industrials sharply cut stock buybacks but maintained the dividend payout ratios.

Julio and Ikenberry (2004) find that most of the resurgence of dividends can be attributed to "maturity hypothesis" which states that as companies mature and reach the stage where their investment opportunities shrink, they start paying out a greater portion of their earnings. Brava et. al (2003) conclude using extensive surveys and interviews of corporate executives that dividend policy is extremely conservative. For companies that already pay dividends maintaining the dividend-level is extremely important but only firms with sustainable and increasing earnings are likely to consider increasing or initiating dividends.

High Dividend Yield Correlates to High Stock Return

The relation of dividend yield and stock return has long been studied. For the period 1925 to 1975, Benjamin Graham (Rea, 1977) reported that stocks with a dividend yield greater than two-thirds of the AAA bond yield had an average compound growth rate of 19.5% as compared to a 7.5% return for the Dow during the same period. Fama and French (1988) and Hodrick (1992) also found evidence supporting a positive relationship between dividend yields and stock returns.

Recently, Lewellen (2004) states that dividend yield predicts market returns during 1946-2000, as well as in various subsamples. Following Miller and Modigliani, Robertson and Wright (2006) provide evidence on predicting U.S. aggregate stock returns using dividend yields. They construct a measure of dividend yield that includes all cash flows to shareholders. The adjusted dividend yield has strong and stable predictive power for returns and is robust to various tests.

The predictive power is confirmed by Henkel et al. In their 2011 paper , they use dividend yield and short rate as a short-term aggregate return predictor. The model outperforms the historical average out-of-sample in the US. Maio and Santa-Clara (2015) showed a positive relation between dividend yield and aggregate stock return for large firms in the long run. Last but not least, Bollerslev, Xu, and Zhou (2015) confirm that dividend yield positively forecasts long-horizon returns.

International evidence of positive relationship between dividend yield and stock return can be found in Canada, France, Germany, Hong Kong, Singapore, the UK , Belgium , Japan , and China .

However, there are various opinions on the relation between dividend yield and stock return. Ang and Bekaert (2007) state that dividend yields predict excess returns only at short horizons together with the short rate and do not have any long-horizon predictive power. At short horizons, the short rate strongly negatively predicts returns. In his Handbook of the Economics of Finance, Schwert observes the size effect,

the value effect, the weekend effect, and the dividend yield effect seem to have weakened or disappeared after the papers that highlighted them were published . Corzo Santamaria et al. (2014) state that companies within a specific range of dividend yield have superior returns. In other words, dividend yield and stock return exhibit an inverted U-shape.

Low Payout Ratio Leads to sustainable Dividend

Many research focuses on the relation between dividend yield and stock return. Surprisingly, not many focus on the relation between payout ratio and the stock return. Using robust estimation methods, McManus, Gwilym, and Thomas (2004) find that the payout ratio does indeed have an important impact on the statistical significance of dividend yield itself in explaining returns, and suggest that it conveys signaling information beyond that of dividend yield. Furthermore, Gwilym et al (2006) claim that higher payout ratios do indeed lead to higher real earnings growth—but not to higher real dividend growth and future returns. Karpavicius (2014) implies that firms with more stable dividend stream are more valuable because firm value depends on payout policy. This theory explains why dividends are rigid over time. Zacks dividend strategy utilizes payout ratio as a quality control factor to maximize investors' risk-adjusted return based on a stable dividend stream.

Asset Diversification Alpha

The benefits of diversification for holding different asset classes in a portfolio are well documented. This is true, irrespective of the type of assets that make up the portfolio. A rule of thumb for measuring the benefits of diversification is Correlation. However, Statman and Scheid (2004) show that the return gap can be a better measure of diversification since the benefits of diversification that arise are not only a function of correlations between asset returns but also depend on the standard deviation of asset returns .

The lower the correlation among the different asset classes, the greater the benefit from diversification. The table below shows the correlation coefficients between the different return series of asset classes.

An example of a study of non-equity instruments providing diversification benefits when included in equity portfolios is by Hoesli, Lekander, and Witkiewicz (2004) . According to Hoesli, Lekander, and Witkiewicz, real estate was found to be an effective asset investment class to diversify an equity portfolio. Additionally, the use of both domestic and international real estate assets further increased diversification.

This research supports the findings of earlier studies. According to the earlier research adding REITs to diversified portfolio additionally boosted annualized risk-adjusted returns by 80 basis points for the period of 1972-2001. From the period of 1992-2001, including REITs into the diversified portfolio increased annualized returns by 1.3%.

Correlation of historical monthly returns from 12/31/2014 to 9/30/2018

Sleeve	COM's	ADR's	REIT's	MLP's	Pfd's	CEF's
COM's	1	0.37	0.31	0.57	0.39	0.42
ADR's	0.37	1	0.12	0.53	0.27	0.68
REIT's	0.31	0.12	1	0.22	0.46	0.45
MLP's	0.57	0.53	0.22	1	0.29	0.56
Pfd's	0.39	0.27	0.46	0.29	1	0.51
CEF's	0.42	0.68	0.45	0.56	0.51	1

Source: Bloomberg, Zacks Investment Research

Semi-Active Indices and the Changing Outlook of the ETF Market

Increasingly, the scope of ETFs has grown and become more sophisticated from it starting points of SPDRs and QQQs to broader instruments covering style- and sector-specific indices and strategies. Investors are becoming increasingly aware of the benefits that ETFs have over more traditional, less efficient financial products that have dominated the options to both institutional and individual investors. Thanks to lower ownership costs, better liquidity, and tax benefits, ETFs are becoming a more popular choice among all investors.

The major difference that separates one ETF from the rest is the underlying index on which the ETF is based. The majority of ETFs that exist currently are based on passive indices, eliminating the opinions and judgments that portfolio managers of traditional financial instruments use in their selection process.

Firms such as Zacks Investment Management aspire to bridge the gap between active investment instruments and passive indices to offer investors an alternative that blends the benefits of quantitative management with the benefits of the ETF structure. Before selecting an ETF, or any indexed instrument, be certain that you feel comfortable with the index objective, its structure, and the firm creating it. After all, in the unmanaged world of investing, the index is the de facto manager.

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Disclosure:

Past performance is no guarantee of future results. Inherent in any investment is the potential for loss. The Indices presented are for comparative purposes only and an investor cannot invest directly in an Index. The Zacks Multi-Asset Income Index™ is designed to identify companies from the universe of small cap stocks with potentially superior risk-return profiles as determined by Zacks Investment Management. The Zacks Multi-Asset Income Index™ is a modified equal-dollar weighted index (subject to modification), comprised of approximately 125-150 securities selected quarterly from a universe of the income-generating listed securities by asset type. Throughout this report, different dates have been used in graphs and charts. Chosen dates reflect the maximum overlapping period of data for each component of the chart. The S&P 500 Index is a well-known, unmanaged index of the prices of 500 large-company common stocks, mainly blue-chip stocks, selected by Standard & Poor's. The S&P 500 Index assumes reinvestment of dividends but does not reflect advisory fees. The Dow Jones U.S. Select Dividend Index is a dividend based, unmanaged index of the prices of 100 dividend-paying stocks selected by the Dow Jones & Company, Inc. The Dow Jones U.S. Select Dividend Index assumes reinvestment of dividends but does not reflect advisory fees. The volatility of the benchmarks may be materially different from the performance obtained by a specific investor. Zacks Investment Management's only relationship to Invesco Ltd. is Zacks' licensing to Invesco certain Zacks trademarks, Indices and trade names, which is composed by Zacks without regard to Invesco, any product or any investor. The Zacks Multi-Asset Income Index™ was created by, and is a trademark of, Zacks Investment Management and has been licensed for use by NYSE MKT LLC. Index Products traded on the NYSE MKT that is based on the Index are not sponsored by Zacks and Zacks does not guarantee the accuracy or completeness of the Index, or the results to be obtained by any person from the use of the Index or the trading of Index Provider Index products.

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