

Investing in Dividends

Semi-Active versus Passive Strategies

Christopher Huemmer, CFA and G. Raghuram, PhD. Introducing the Zacks Multi-Asset Income Index™

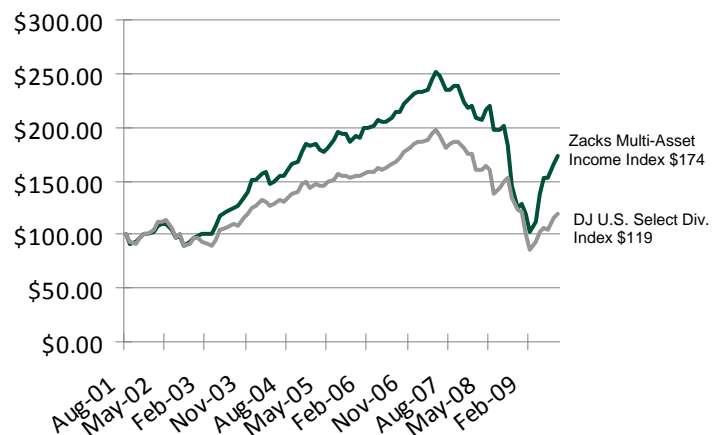
Key Points:

1. Zacks Investment Research has created the Zacks Multi-Asset Income Index, the first yield-oriented index to combine equities, preferred stocks, ADRs, REITs, master limited partnerships (MLPs), and closed-end funds.
2. The objective of the Zacks Multi-Asset Income Index is to outperform passive dividend benchmarks using a proprietary model based on dividend growth, the capacity to increase the current dividend, liquidity, and dividend yield.
3. 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 means of generating alpha.
4. Through the use of different asset classes as significant portions of the index, the Zacks Multi-Asset Income Index makes use of the lower correlation between these asset classes to minimize risk through greater diversification.
5. Zacks has licensed its Multi-Asset Income Index to Claymore Securities, Inc. for the creation of an Exchange Traded Fund (ETF) that we believe will offer investors a new and significantly better way to invest in income generating securities.
6. The Zacks Multi-Asset Income Index has a projected yield distribution of 5.63% while the Dow Jones U.S. Select Dividend Index has a projected yield of 3.73%.

As the graph below indicates, over the past eight years the Zacks Multi-Asset Income Index produced significant excess returns compared to the Dow Jones U.S. Select Dividend Index. Over the past eight years, a \$100 invested in the Zacks Multi-Asset Income Index grew to \$174 while the same \$100 invested in the Dow Jones U.S. Select Dividend Index grew only to \$119.

Zacks Multi-Asset Income Index versus DJ U.S. Select Dividend Index

Zacks Multi-Asset Income Index Performance Comparison
Growth of \$100 over the period Aug. 2001 to Aug. 2009



Source: Zephyr StyleADVISOR:
Zacks Investment Research

Description

Zacks Multi-Asset Income Index™

Zacks Investment Research continues to develop innovative “semi-active” indices whose constituents are chosen based on merit.

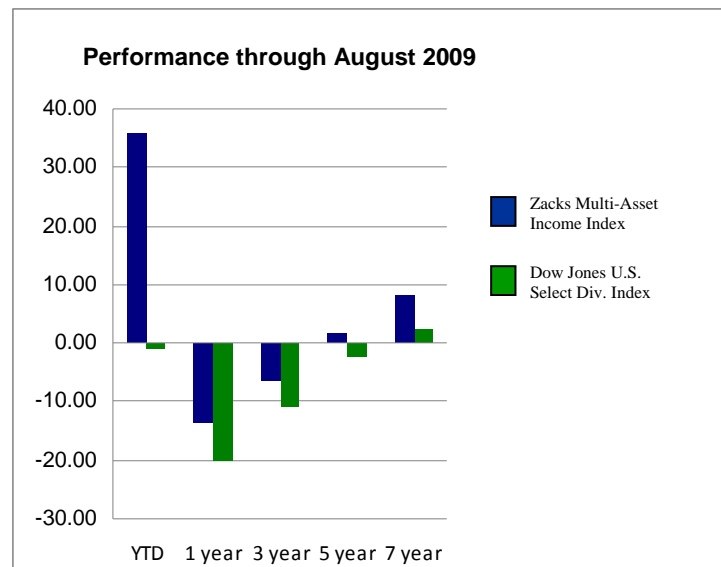
Zacks has launched the first yield-oriented index that combines common stocks, preferred stocks, master limited partnerships (MLPs), closed-end funds, REITs, and ADRs to maximize yield and minimize risk through diversification.

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 less than perfect correlations between different asset classes to provide diversification benefits and minimize both “stock-specific” and “asset-specific” risks.
- Target securities with high yields and liquidity.
- Strategically weight the index based on liquidity to ensure the investability of the index.

The Zacks Multi-Asset Income Index contains 125-150 securities that are weighted on a liquidity basis within each asset class. 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.



Comparative Performance Statistics

Performance Table: August 2001 - August 2009

vs. Dow Jones U.S. Select Div. Index

	Annualized Return (%)	Cumulative Return (%)	Std Dev (%)	Sharpe Ratio	Annualized Excess Return (%)	Beta vs. DJ Select	Alpha vs. DJ Select	R ² vs. DJ Select
Zacks Multi-Asset Inc Index	7.18	74.09	19.34	0.25	4.94	0.96	5.40	71.89
Dow Jones US Div. Index	2.24	19.35	17.05	-0.01	0.00	1.00	0.00	100.00

Performance

**Performance Comparison Through August 2009
(not annualized if less than 1 year)**

	YTD	1 year	3 year	5 year	7 year	8 year
Multi-Asset Inc.	35.93	-13.78	-6.57	1.75	8.29	7.18
DJ US Select Div.	-0.84	-20.03	-10.86	-2.44	2.60	2.24

Index Constituents are the stocks that make up an index. Different Index Sponsors adopt different approaches to the selection process.

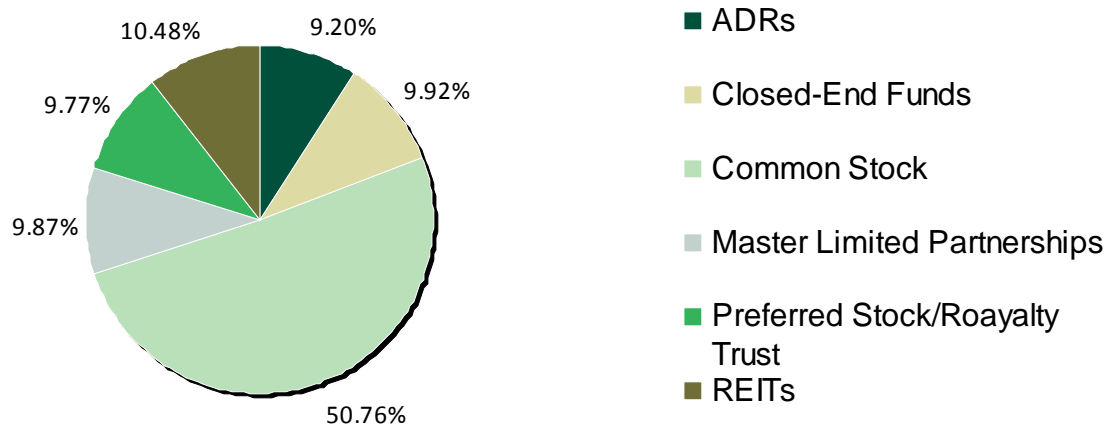
Zacks strategic indexing approach emphasizes constituent selection while passive indexing emphasizes replicating the performance of the entire market segment.

Studies have shown that strategic, discriminating selection can add significantly to total return.

Performance

The Zacks Multi-Asset Income Index provides significantly higher returns with a slightly lower Beta than the Dow Jones Select Dividend Index. Because the Multi-Asset Income Index produces higher returns while being less volatile, its Sharpe Ratio is significantly higher than the Select Dividend Index.

Asset Allocation as of July 2010

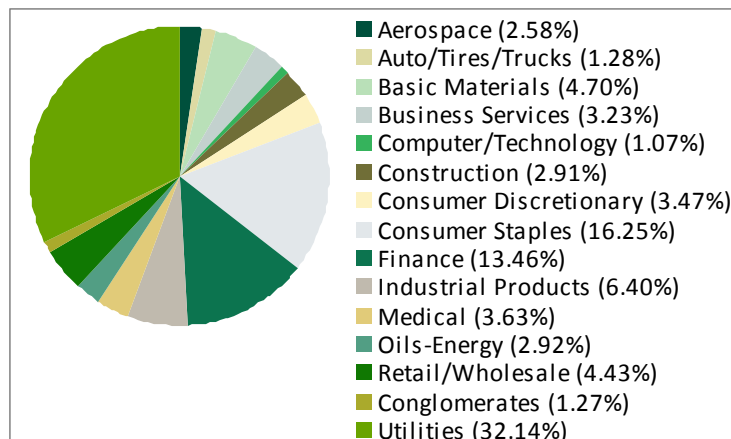


Characteristics

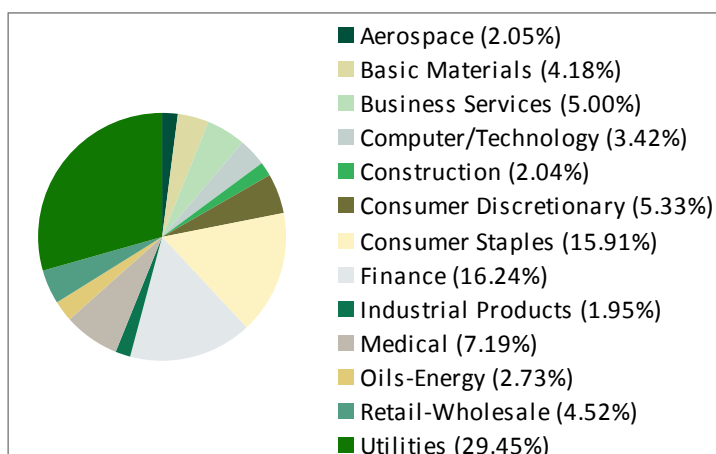
Sector Allocations (as of July 2010)

	Dow Jones Select U.S. Dividend Index	Common Stock Portion of Multi-Asst Inc. Index (50.76%)
Aerospace	2.58%	2.05%
Auto-Tires-Trucks	1.28%	0.00%
Basic Materials	4.70%	4.18%
Business Services	3.23%	5.00%
Computer/Tech	1.07%	3.42%
Construction	2.91%	2.04%
Consumer Discretionary	3.47%	5.33%
Consumer Staples	16.25%	15.91%
Finance	13.46%	16.24%
Industrial Products	6.40%	1.95%
Medical	3.63%	7.19%
Oils-Energy	2.92%	2.73%
Retail-Wholesale	4.43%	4.52%
Conglomerates	1.27%	0.00%
Utilities	32.14%	29.45%

Sector Allocation of Dow Jones Select U.S. Dividend Index as of July 2010



Sector Allocation of Common Stock Portion of Zacks Multi-Asset Income Index (50.76% of total Index) as of July 2010



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.

Dividend Yield Alpha

The re-emergence of dividends after a significant decline in dividend payouts toward the end of 1990s has attracted the attention of many researchers. While the recent dividend tax rate cut by President Bush might seem the obvious reason for the rebound of dividends, Julio and Ikenberry (2004)¹ argue that the rebound started much earlier in 2000

1. Julio, B. and Ikenberry, D., 2004, "Reappearing Dividends," Journal of Applied Corporate Finance 16, 89-100.

Academic Research

and so the tax cut only partially explains the re-emergence of dividend strategies as a favorable investment approach.

Julio and Ikenberry (2004) examine this issue in detail. They state that one of the causes lies in the maturity hypothesis. Grullon, Michaely and Swaminathan (2002)² refer to the important linkage between dividends and firm maturity or life cycle. This hypothesis states that as a firm's investment opportunities shrink due to a natural maturation process, there is an increasing need to increase its cash payout from its free cash flow. The last three decades saw a massive number of new firms being established. Those firms that survived the intense competition may now be in such a stage of their life cycle that their investment opportunities are shrinking. As a result of this maturation process more firms are starting to pay out a greater portion of their earnings as dividends.

The relationship between dividend yields and stock returns has been studied for a long time by researchers. For the period 1925 to 1975, Benjamin Graham (Rea, 1977)³ 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)⁴ and Hodrick (1992)⁵ also found evidence supporting a positive relationship between dividend yields and stock returns.

Benefits of Combining the Zacks Multi-Asset Income Index with Non-dividend Portfolios

An interesting finding in this research is the complimentary nature of high dividend yielding stocks with a portfolio the currently does not have a dividend focus. The reason behind this benefit has been the emergence of a U-shaped relationship between dividend yield and stock returns when zero-dividend stocks were included in the studies conducted by Blume (1980)⁶; Litzenberger and Ramaswamy (1979 and 1982)⁷; Elton, Gruber, and Rentzler (1983)⁸; and Keim (1985 and 1986)⁹. The U-shaped relationship implies that both companies with high-dividend yields and companies that do not pay dividends tend to outperform companies with dividend yields between the extremes.

Gwilym, Morgan and Thomas (2000)¹⁰ report a similar U-shaped relationship in the UK with high-dividend yield companies and zero dividend companies outperforming companies with dividend yields between the extremes. However it is worth noting that the highest dividend yield stock portfolio has higher returns than the zero-dividend stock portfolio and also that only the highest dividend yield stock portfolio has a statistically significant positive risk adjusted return. It is also important to note that when examining only stocks that pay dividends, the relationship

2. Grullon, Gustavo, Roni Michaely and Bhaskaran Swaminathan, 2002, "Are Dividend Changes a Sign of Firm Maturity," *Journal of Business* 75 (3), 387 – 424.

3. Rea, J.B., 1977, "Remembering Benjamin Graham – Teacher and Friend," *The Journal of Portfolio Management*, 3(4), 66 –72.

4. Fama, E.F. and French, K.R., 1988, "Dividend Yields and Expected Stock Returns," *Journal of Financial Economics*, 22(1), 3–26.

5. Hodrick, R.J., 1992, "Dividend Yields and Expected Stock Returns: Alternative Procedures for Influence and Measurement," *Review of Financial Studies*, 5(3), 357 –86.

6. Blume, M.E., 1980, "Stock Returns and Dividend Yields: Some More Evidence, *Review of Economics and Statistics*," 62, 567–77.

7. Litzenberger, R.H. and Ramaswamy, K., 1979, "The Effect of Personal Taxes and Dividends on Capital Asset Prices: Theory and Empirical Evidence," *Journal of Financial Economics*, 7(2), 163 –96.

Litzenberger, R.H. and Ramaswamy, K., 1982, "The Effects of Dividends on Common Stock Prices: Tax Effects or Information Effects?" *Journal of Finance*, 37(2), 429 –43.

8. Elton, E., Gruber, M. and Rentzler, J., 1983, "A Simple Examination of the Empirical Relationship between Dividend Yields and Deviations from the CAPM," *Journal of Banking and Finance*, 7(1), 135–46.

9. Keim, D.B., 1985, "Dividend Yields and Stock Returns: Implications of Abnormal January Returns," *Journal of Financial Economics*, 14(3), 473 –89.

Keim, D.B., 1986, "Dividend Yields, Size and the January Effect," *Journal of Portfolio Management*, 12(2), 54–60.

10. Banz, Rolf W., "The Relationship Between Return and Market Value of Common Stocks," *Journal of Financial Economics* 9 (1981): 3-18.

Payout Ratios

between dividend yield and stock returns are linear; namely as dividend yields increase, stock returns are likely to increase as well.

Significance of Payout Ratios

The Payout Ratio of any stock is simply the percentage of earnings that are given to the shareholder in the form of dividends. Lamont (1998)¹¹ shows that aggregate dividend payout ratio forecasts aggregate excess returns on both stocks and corporate bonds. The payout ratio is correlated with business conditions and this gives it predictive power for returns - it contains information about future stock and bond returns that is not captured by other variables. When the payout ratio is high, expected returns are high.

Asness (2003)¹² argue that payout ratios serve the purpose of dividend signaling (high payout ratios disseminate positive private information and low payout ratios disseminate negative private information). However, Julio and Ikenberry (2004) take an opposite view of dividend signaling using payout ratios. They opine that in March 2000, technology stocks reached their peak on NASDAQ and thereafter, the Enron scandal and other corporate abuses shook investor confidence. Julio and Ikenberry (2004) find that these low leverage firms with historically low dividend payouts show a large swing in payout policy around the time of 2000 peak. Their research leads to the conclusion that companies try to manipulate investor sentiment by large increases in dividend growth; however, these manipulations negatively influence payout ratio. Thus, payout ratios have additional significance in thwarting these corporate manipulations and help determine whether the dividend growth is sustainable. Shiller (2000) also makes a similar argument in his work regarding the high valuations of stocks at the time of the 2000 peak.¹³

Additionally, there are studies which assess the importance of payout ratio in dividend strategies. McManus, Gwilym and Thomas (2004)¹⁴, in their study of the UK market, state that payout ratio may convey additional signaling information, over and above that of dividend yield alone, for investors. They believe that this variable offers additional information to conventional dividend signaling models as managers adjust dividend payments to changing financial circumstances.

Gwilym, Seaton and Thomas (2005)¹⁵ study the application of the payout ratio filter after the application of the dividend yield filter on four classifications of stocks in the UK market. They find that when absolute returns were considered application of the payout ratio filter (subsequent to the application of the dividend yield filter) yielded returns superior to those from pure dividend strategies.

11. Lamont, Owen, 1998, "Earnings and Expected Returns," *Journal of Finance* 53.

12. Asness, C.S., 2003, "Surprise! Higher Dividends = Higher Earnings Growth," *Financial Analysts Journal*, vol. 59, no. 1 (January/February): 70-87.

13. Shiller, Robert, J., 2000, "Irrational Exuberance," Princeton University Press.

14. McManus, Ian D., Ap Gwilym, Owain and Thomas, Stephen, 2004, "The Role of Payout Ratio in the Relationship between Stock Returns and Dividend Yield," *Journal of Business Finance & Accounting*, Vol. 31, No. 9-10, pp. 1355-1387.

15. Gwilym, Owain Ap, Seaton, James and Thomas, Stephen, 2005, "Dividend Yield Investment Strategies, the Payout Ratio and Zero Dividend Stocks," *Journal of Investing*, 14, (4), 69-74.

Asset Diversification

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) shows that Standard Deviation 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 standard deviation of asset returns.¹⁶

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)¹⁷. 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%.¹⁸

Correlation of Historical Excess Returns vs. S&P 500 by Asset Class

	Common Stock	ADRs	REITs	MLPs	Preferreds	CEFs
Common Stock	1.00	0.36	0.60	0.50	0.43	0.29
ADRs	0.36	1.00	0.47	0.16	0.47	0.32
REITs	0.60	0.47	1.00	0.56	0.52	0.49
MLPs	0.50	0.16	0.56	1.00	0.48	0.77
Preferreds	0.43	0.47	0.52	0.48	1.00	0.62
CEFs	0.29	0.32	0.49	0.77	0.62	1.00

16. Meir Statman and Jonathan Scheid, Dispersion, Correlation and the Benefits of Diversification – May, 04.

17. Martin Hoesli, Jon Lekander and Witold Witkiewicz, International Evidence on Real Estate as a Portfolio Diversifier – 2004.

18. NAREIT Publication, Ibbotson Updates Finds REITS Improve Portfolio Performance Over Time – 2002.

ETFs

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

Increasingly, the scope of ETFs has grown and become more sophisticated from its 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 off of passive indices, eliminating the opinions and judgments that portfolio managers of traditional financial instruments use in their selection process.

Firms such as Zacks Investment Research 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.

ZACKS INVESTMENT RESEARCH

111 NORTH CANAL STREET
CHICAGO, ILLINOIS 60606

EMAIL: ETF@ZACKS.COM



Semi-Active Indices
DESIGNED FOR INVESTMENT

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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 Research. 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. Charts produced using StyleAdvisor by Zacks Investment Research. 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 Research's only relationship to Claymore Securities is Zacks' licensing to Claymore certain Zacks trademarks, Indices and trade names, which is composed by Zacks without regard to Claymore, any product or any investor. The Zacks Multi-Asset Income Index™ was created by, and is a trademark of, Zacks Investment Research and has been licensed for use by the American Stock Exchange LLC. Index Products traded on the Amex that are 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.