

Understanding the Dividend Maximisation Strategy.

What is Dividend Stripping?

Dividend stripping involves buying shares in a company prior to the ex-dividend date¹ and selling those shares after the ex-dividend date. The goal is to capture the dividend, and any associated franking credits often referred to as imputation credits.^{2 3}

Dividend stripping is not a strategy to create wealth, but rather a strategy to maximise income through prudent portfolio management.

Further, franking credits can be rather lucrative and appealing with the benefits of potential tax deductions, especially in superannuation funds that are in pension phase. Imputation credits are the equivalent of cash because they are claimed as deductions or refunds to the Australian Tax Office.

Dividend Stripping v Alternative Investment Options.

Dividend stripping is generally successful in an environment when there is deflation and interest rates are low with the market seeking higher yields.

Dividend stripping, in comparison to options share trading often seemed as more simplistic with no complex fundamental analysis and further, the added assurance of tax benefits. This is why dividend stripping is often thought of as negative gearing.

As opposed to buying and selling stocks, with the dividend stripping strategy, an investor only needs to buy the shares of a stock before the ex-dividend date and sell them, on or after the ex-dividend date. Comparatively, share trading requires research, stock evaluation and is subject to market movements.

The same can be said for dividend stripping, however if the share prices fall after the dividend announcement, an investor is able to wait until the price returns to its original value. The dividend capture strategy offers continuous opportunities for profit because, every month multiple stocks in the ASX 100 are paying dividends.

In comparison to options trading, it is only suited to highly experienced investors, with ongoing stock monitoring and it has far higher risks with investors potentially able to lose their full capital investment. With dividend stripping, the investor still holds his shares with further dividends down the track.

¹ Ex- dividend date is the date that shares trade without entitlement to receive a dividend. Anybody who purchases shares on an ex-dividend date is not entitled to receive the dividend.

² Franking credits: When a company pays tax on its profits, it can attach franking credits (representing that tax paid) to the dividends it distributes. Shareholders then use these credits to offset their own tax liabilities, effectively receiving credit for the tax already paid by the company. If the franking credits exceed the shareholder's tax bill, the excess may be refunded.

³ <https://www.marketindex.com.au/news/how-to-invest-in-asx-dividend-stocks-plus-the-dividend-stripping-strategy>

It is important to note that the dividend trading strategy is not risk free and that it is important to obtain tax advice as dividends beyond a certain threshold may be taxable. The trading strategy, like share trading is also not immune to market price fluctuation risk.

So, how does it work?

Stocks go ex div in February, March, May and then June of each year. That's half yearly dividends paid. During the second half of the year, the same stocks come around in August, September, October and December

This means that approximately 47 days before the middle of February, an investor can purchase stocks that go ex div in February only. Certain factors that will determine whether the stocks are purchased is dependent on the below 3 variables:

1. Macro: Interest rates, currency, sector, overseas markets, commodity markets, market sentiment, etc.
2. Fundamental Analysis: PE ratio's, EPS, dividend yield, Franking % and Debt/Equity, etc.
3. Technical analysis: Charting the approx time to buy and sell shares based on trend lines, volume, candlesticks, moving average lines, RSI, etc.

If the variables outlined above are not satisfied, no purchase is made, and the capital is retained. As an illustrative example, a starting capital of 100k would require 10 stocks of 10k parcels each to be purchased. The investor would need to find 10 stocks from the February dividend listing that satisfy all 3 variables.

Once the stocks are purchased, the stocks are monitored for the next 47 days up to its ex div date. If there is a capital gain, after commission both ways, greater than the div and franking in those 47 days, the sale of the stock should be considered to purchase a stock from the March dividend list.

The main reasons for taking profits are that once a stock goes ex dividend, it drops by the dividend amount on the same day in any case.

Illustrative Example

As an illustrative example, an investor would rather take a capital gain greater than the dividend before it goes ex div? If the objective was to make 3.5% - 4% net return, (because each stock is yielding 7.5% p/a approximately), and you have this in hand, why risk losing it in the market especially in times of such high volatility. Use the capital for the next stock and keep repeating it for May, June, then August, September, October and December. That way with that same original parcel of 10k, it's possible to have collected 8 dividends in one calendar year rather than 2 and a small net capital gain as well. The investor is never selling at a loss to capture further income.

If you don't have a capital gain in the 47 days, you hold on for the dividend and the franking, and sell after that, provided you still have a capital gain on that parcel.

Ideally, you never sell at a loss and you have to be patient to wait until the stock reaches it's cost price, and the same process is repeated.

If after the purchase of the first round of shares and the market turns bearish, and the investor is left holding only the February dividend stocks, the investor holds onto the stocks until the market improves. The investor will still earn approximately 7.5% per annum based on today's average high yielding blue chip shares.

It is important to remember the income is based on cost price, not current value. If the portfolio value drops from 100k to 80k, the investor is still earning the income from the 100k capital.

Conclusion

The dividend stripping strategy is not free from risks, however there is the possibility that it can deliver greater returns, whilst your capital is not invested for longer periods. This strategy could provide regular income by making it more appealing to income focused investors.

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