Should You Invest in a Dividend ETF or its Top Holdings?

Description

Since exchange-traded funds (ETFs) are popular low-cost investments, I thought it would be interesting to compare a dividend ETF with its top holdings. **VANGUARD FTSE CDN HIGH DIV YLD INDEX ETF** (TSX:VDY) tracks the FTSE Canada High Dividend Yield Index, which had 91 holdings as of January 31.

The ETF's holdings

The ETF's top 10 holdings make up 65% of the fund. And its top three holdings, **Royal Bank of Canada** (TSX:RY)(NYSE:RY), **Toronto-Dominion Bank** (TSX:TD)(NYSE:TD), and **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), make up 36.1% of the fund.

The remaining top seven holdings include **Bank of Montreal** (TSX:BMO)(NYSE:BMO), **Manulife Financial Corp.** (TSX:MFC)(NYSE:MFC), **Canadian Imperial Bank of Commerce** (TSX:CM)(NYSE:CM), **TransCanada Corporation** (TSX:TRP)(NYSE:TRP), **Sun Life Financial Inc.** (TSX:SLF)(NYSE:SLF), **Potash Corporation of Saskatchewan Inc.** (TSX:POT)(NYSE:POT), and **Thomson Reuters Corp.** (TSX:TRI)(NYSE:TRI).

An overwhelming concentration of 64.3% of the fund was in financials, 14.6% was in oil and gas, 5.6% was in telecommunications, 5.2% was in consumer services, 4.6% was in utilities, and less than 4% was in each of basic materials, industrials, and consumer goods.

Additionally, the ETF had zero exposure to healthcare and technology. Investors can get better exposure to those sectors in the U.S.

It's true that any ETF offers more diversification compared to buying individual stocks. However, unitholders should know which sectors their ETFs are exposed to, so they minimize overlap and maximize diversification to reduce risk.

The ETF's dividend

The ETF pays a monthly distribution. Here are the last 12 distributions:

Payment Month	Distribution per unit
March 2016	$0.12700
February 2016	$0.07305
January 2016	$0.07486
December 2015	$0.12505
November 2015	$0.07258
October 2015	$0.07925
September 2015	$0.12583
August 2015	$0.08084
July 2015	$0.07889
June 2015	$0.13687
May 2015	$0.06177
April 2015	$0.08750
Total:	$1.12

Every June, September, December, and March, the distribution is bigger because the majority of the underlying companies pay dividends in those months.

There's no good way to project how much in dividends the ETF will generate for your portfolio. For example, one or more companies that paid dividends in June have cut their dividends (which is evident due to the smaller distribution in September compared to June).

Perhaps one could take the distribution of the last three months and multiply it by four to project the annual dividend payout, in which case, it'd be $1.08 per unit, equating to a 4.1% yield as of Friday's close.

Costs

The management fee and management-expense ratio are associated with the Canadian High Yield ETF, costing a total of 0.50% per year. Buying and selling individual stocks costs about $10 at the big banks and less at other discount brokerages. So, depending on how much you buy or sell each time (or even if you choose not to sell), the cost could be smaller than buying ETFs.

What if you choose individual dividend stocks?

Buying individual dividend stocks gives you more control than buying ETFs.

By choosing individual dividend stocks for your portfolio, you can allocate the exact percentage you want in specific sectors or companies. You can even set up rules, such as getting a maximum of 5% of your dividends from a specific company and getting a maximum of 15% of your dividends from any sector. Additionally, you can also buy when a dividend stock is discounted. It's easier to determine if a company is cheap versus an ETF that consists of many companies.

Dividend cuts and increases apply to both the dividend ETF and dividend stocks. However, it's easier to project dividends of individual companies because you can assess the safety of their dividends. For example, dividends from oil and gas and basic material companies are less reliable than utility dividends.

If investors care about dividend reliability and growth, selecting the highest-quality dividend stocks with stable business cycles may be safer than buying ETFs.

For example, I can decide to buy and hold only one bank (Toronto-Dominion Bank), one life insurance company (Manulife), one energy infrastructure company (TransCanada), and so on. And I can choose to invest the same amount in each company or invest more in the ones with more positive outlooks. At the same time, I can easily project their dividend income.

By investing $5,000 in each of the three companies, I'd get an average yield of 4.3%, equating to an annual income of $645, assuming no dividend increases or cuts.

CATEGORY

1. Bank Stocks
2. Dividend Stocks
3. Energy Stocks
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1. NASDAQ:TRI (Thomson Reuters)
2. NYSE:BMO (Bank of Montreal)
3. NYSE:BNS (The Bank of Nova Scotia)
4. NYSE:CM (Canadian Imperial Bank of Commerce)
5. NYSE:MFC (Manulife Financial Corporation)
6. NYSE:RY (Royal Bank of Canada)
7. NYSE:TD (The Toronto-Dominion Bank)
8. NYSE:TRP (Tc Energy)
9. TSX:BMO (Bank Of Montreal)
10. TSX:BNS (Bank Of Nova Scotia)
11. TSX:CM (Canadian Imperial Bank of Commerce)
12. TSX:MFC (Manulife Financial Corporation)
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