THE POWER OF DIVIDEND GROWERS vs. DIVIDEND CUTTERS IN YOUR INVESTMENT PORTFOLIO

by Mark Bentley, Executive Vice President, BTS Asset Management

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In a financial landscape marked by persistent inflation, it's important to consider the advantages of dividend growth investing within a diversified portfolio. This article delves into the compelling case for incorporating dividend growers into your investment strategy, contrasting them with dividend cutters. Dividend growers, companies that consistently increase their dividend payouts, have a history of outperforming their counterparts while offering a lower level of volatility. These companies weather market turbulence well and can serve as a hedge against rising costs while generating attractive income opportunities with the potential for growth.

Distinguishing Features of Dividend Growers

1 **Superior Performance and Lower Risk:**

- Historical data reveals that dividend growers have consistently outperformed non-dividend paying companies while exhibiting less volatility.
- Companies with a track record of persistent dividend growth have provided competitive returns, especially during periods of market uncertainty.

2 **Resilience to Economic Challenges:**

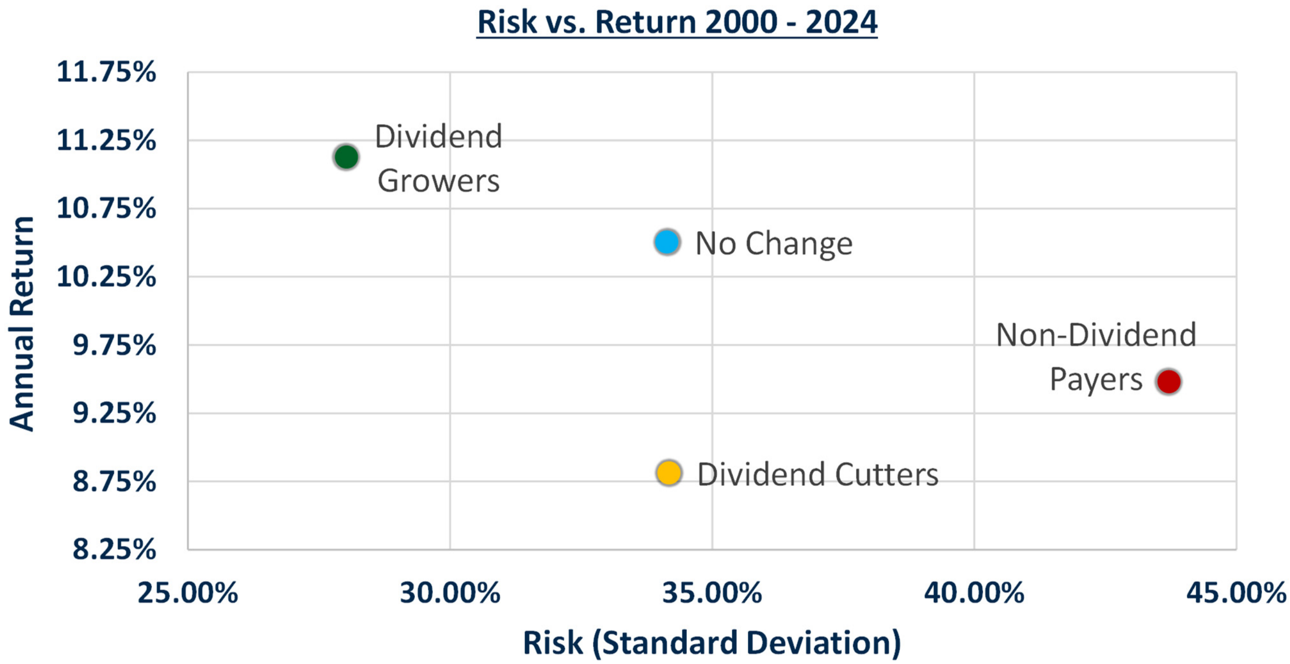
- Dividend growth companies have proven to be less sensitive to rising interest rates and inflation, often outshining other dividend categories.

3 **Outperformance in Various Market Environments:**

- Over the long term, dividend growers have delivered desirable returns with lower risk compared to companies that maintain their dividends, pay no dividends, or reduce/eliminate them.

The Role of Dividends in Equity Total Return

While dividends are not guaranteed and can fluctuate, they have historically contributed significantly to equity total return over the decades. The income generated by dividends complements capital appreciation strategies by reducing volatility and contributing to overall returns. This is particularly valuable in times of market turbulence, as companies with robust balance sheets and the financial strength to support dividend growth can help mitigate volatility.



Source Bloomberg. 12/31/1999 to 12/31/2024. Results are obtained by considering the constituents of the S&P 500 at the last trading day of each year between 12/31/1999 and 12/31/2023. At the last trading day of each year, each stock is categorized by their 1-year gross dividend growth rate and dividend yield for the entire current year. Stocks with a positive 1-year dividend growth rate and positive dividend yield are considered Dividend Growers. Stocks with a negative 1-year dividend growth rate and positive dividend yield are considered Dividend Cutters. Stocks with a 1-year dividend growth rate of 0 and a positive dividend yield are considered No Change. Stocks without a 1-year dividend growth rate or dividend yield are considered Non-Dividend Payers. The next year returns for each of these stocks in their respective categories are compiled for each year based on the categorization at the last trading day of each year between 1999 and 2023 (the first-year returns are from 12/31/1999 to 12/31/2000 and the final year returns are from 12/31/2023 to 12/31/2024). The average return of each category is plotted on the y-axis and the standard deviation of each category's returns are plotted on the x-axis, both measured in percentages. Past performance is no guarantee of future performance. For illustration purposes only.

The Balance of Dividend Yield and Growth

Dividend-paying stocks with both yield and consistent dividend growth are considered high-quality investments. They effectively balance regular dividend payments with reinvestment in capital for future growth initiatives. Surprisingly, stocks with the highest payout ratios have not been the best long-term performers. Over the past 20 years, companies with medium and medium-high payout ratios have demonstrated favorable performance.

The Attractiveness of Valuations

Not all dividend-paying companies are created equal. Investors should favor those with sustainable payout ratios, healthy balance sheets, and a proven track record of responsible capital allocation, including returning capital to shareholders in the form of a growing dividend. Focusing on these fundamentals is vital in tempering risks with inflation and higher interest rates expected to squeeze profit margins.

Performance After Interest Rate Increases

The historical data is clear: U.S. equity markets have performed well in previous tightening cycles. Notably, dividend growers and initiators within the S&P 500 have consistently outperformed others following Federal Reserve interest rate hikes.

The Importance of Dividend Growers in a Diversified Portfolio

As we look to the future, many companies are well-positioned to continue increasing their dividends. Investing in companies with sustainable dividend growth not only boosts total returns and reduces portfolio volatility but also offers a growing income stream. This combination of solid capital flexibility and increasing dividend payments can act as a buffer against inflationary pressures and the impact of higher interest rates.

The Importance of Dividend Growers in a Diversified Portfolio (continued)

The historical performance of dividend growers and their resilience to market challenges make a compelling case for considering them in a diversified investment portfolio. With strong balance sheets and a history of sustained dividend growth, these companies provide a sturdy foundation for investors looking to navigate uncertain financial terrain while reaping the benefits of consistent income and long-term growth potential.

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Dividend Growers are stocks with a positive 1-year dividend growth rate and positive dividend yield.

Dividend Cutters are stocks with a negative 1-year dividend growth rate and positive dividend yield.

S&P 500 is an index that includes 500 leading companies in leading industries of the U.S. economy and is a proxy for the total stock market. This is the primary index used for comparison to the portfolio as we believe this portfolio should be used in the equity portion of a client's account.

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BTS:

- ❑ Seeks to preserve capital
- ❑ Aims to offer downside protection and upside potential
- ❑ Strives to reduce volatility while delivering consistent long-term returns

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