The Defensive Characteristics of Dividend Investing

Executive Summary:

- Anchor Capital's research shows that dividend yielding stocks, on average, outperform other equities, both historically and in down markets.
- In our experience, dividend payers tend to be stable, larger cap companies with higher levels of cash flow to support dividend payments. These qualities provide defensive characteristics in an economic downturn.
- We examine the following periods: 2008's severe market downturn, 2018's fourth quarter market corrections, and the course of a full market cycle. In all scenarios examined, on average, the total return of dividend yielding stocks was greater than that of non-dividend yielding stocks.*
- Dividend yielding stocks provide a source of income, which on a total return basis offers even more protection in a down market.

*Please refer to period charts and footnotes 4-8

In a portfolio where a steady source of income and growth is important, we believe there is really only one option: dividend yielding stocks. Anchor Capital's research shows that dividend yielding stocks, on average, outperform other equities, both historically and in down markets.

Some companies in the U.S. are using excess cash flow to raise dividends and buy back stock. Since the start of 2018, companies have raised the dividend approximately 8% and in many cases much higher.[1] In addition, the financial sector, which has been constrained by regulation and stress tests, is now able to distribute cash back to shareholders and provide a higher dividend yield.[2] In our experience, dividend payers tend to be stable, larger cap companies with higher levels of cash flow to support dividend payments. These qualities provide defensive characteristics in an economic downturn, as was the case the fourth quarter of 2018.

Historically, the conventional thinking for many income investors is to invest in the bond market for stability. However, after over three decades of a bull market in U.S. Treasury Bonds, it appears to us that we are now moving into an era of higher interest rates and are therefore realizing muted bond returns. Rising interest rates affect bonds with longer maturities more so than bonds with shorter maturities, but both will face losses until maturity. Investors may think that they should be able to capture higher interest rates; as studies show, the starting bond yield has a high correlation with the 5-year subsequent return of the bond. In a period of low rates, returns on bonds going forward will be low and possibly negative in some years.[3]

Taking a Closer Look at Performance

Using the Russell 3000 broad market benchmark, we examined the stock performance of dividend and non-dividend yielding stocks during several periods: the severe market downturn of 2008, the market correction in the fourth quarter of 2018, and over the course of a full market cycle. As shown in the charts below, in all scenarios, on average, the total return of dividend yielding stocks was greater than that of non-dividend yielding stocks.

We observed the performance of stocks with above market yield, below market yield, and no yield during 2008, a year in which the Russell 3000 fell 37.3% and the S&P 500 fell 37.0%. The weighted average dividend yield of Russell 3000 at year-end 2007 was 1.8%, which we consider to be the market yield. Companies with yields above 1.8% at that time are considered “above market yield,” those with yields below 1.8% are “below market yield,” and those that pay no dividend are referred to as “no yield.”

The population examined includes constituents of the Russell 3000 index beginning December 31, 2007. The stock price performance results below, which do not include dividend reinvestment, clearly show that above market yielding stocks provide the most protection, followed by lower yielding stocks.

Dividend yielding stocks also provide a source of income, which on a total return basis offers even more protection in a down market. The average total return for high yielding stocks was -31% in 2008, as displayed in the far-right column, significantly exceeding the average -34% change in the stock prices.

Downturn of 2008

Dividend Yield[4]	Number of Stocks[5]	12/31/08 Wt. Avg. Mkt. Cap	2008 Average Price Change	2008 Total Return[6]
Above Market Yield	827	$67.7 B	-34.17%	-31.45%
Below Market Yield	635	$65.1 B	-40.67%	-39.76%
No Yield	1,730	$22.3 B	-43.94%	-43.86%
Total	**3,192**	**$56.4 B**	**-38.71%**	**-37.31%**

Source: FactSet financial data and analytics

2018 Market Correction

The same analysis was performed over the most recent correction in the fourth quarter of 2018 producing the same results, offering further justification of our thesis:

Dividend Yield[7]	Number of Stocks[8]	12/31/18 Wt. Avg. Mkt. Cap	4Q18 Average Price Change	4Q18 Total Return[6]
Above Market Yield	910	$113.0 B	-11.28%	-10.53%
Below Market Yield	646	$222.8 B	-17.26%	-16.96%
No Yield	1,478	$225.8 B	-18.33%	-18.29%
Total	**3,034**	**$172.5 B**	**-14.74%**	**-14.30%**

Source: FactSet financial data and analytics

Full Market Cycle (1998-2018)

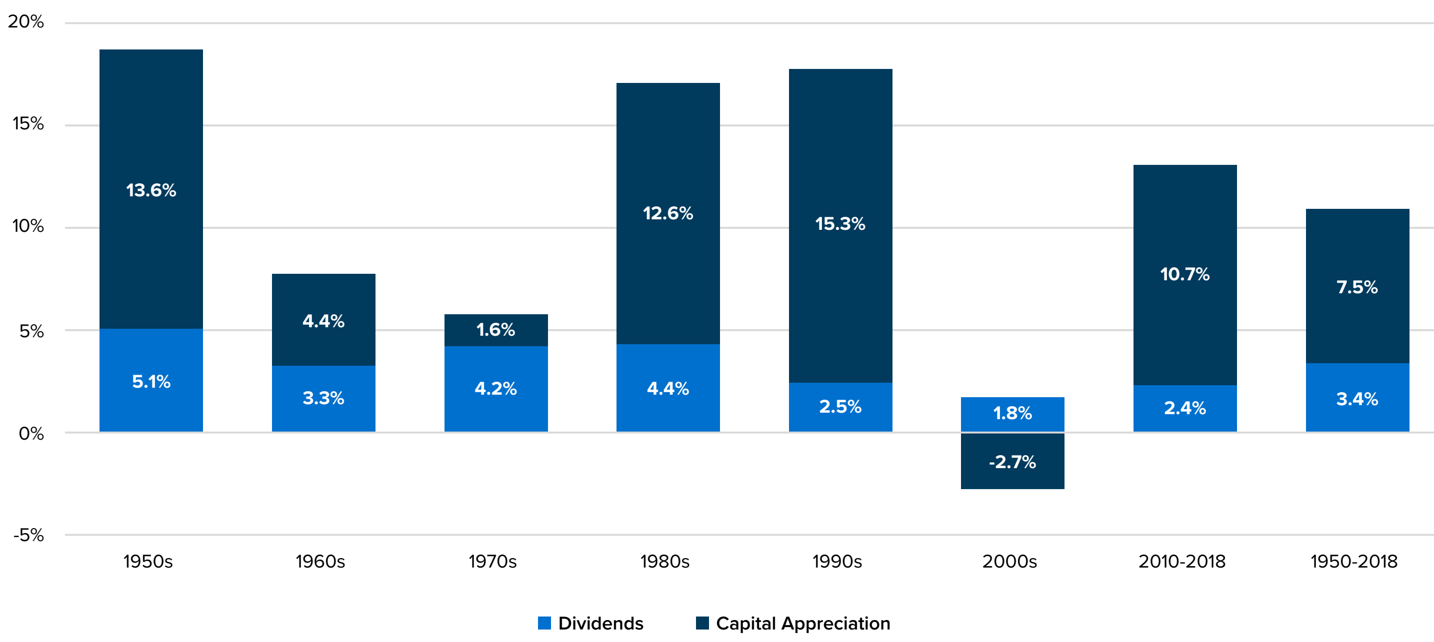
Our research further showed that these results remain consistent over longer-term periods and throughout full market cycles. Using the Russell 3000 Index and an average market yield of 1.8%, we found that stocks with above-average market yields outperformed those with below-average market yields for the twenty-year period ending December 31, 2018. Furthermore, these results were achieved with significantly less volatility, as measured by standard deviation.

Dividend Yield[4]	12/31/18 Wt. Avg. Mkt. Cap	Avg. Price Chg. (annualized)	Total Return (annualized)[6]	Std. Deviation (annualized)
Above Market Yield	$106.2 B	3.83%	7.19%	19.03%
Below Market Yield	$116.6 B	3.08%	5.15%	18.40%
No Yield	$251.1 B	5.41%	6.22%	23.95%
Total	**$134.0 B**	**4.00%**	**5.98%**	**19.36%**

Source: FactSet financial data and analytics

Dividends are a significant contributor to S&P 500 returns for the period between 1950 and 2018. The exhibit below[9] shows how much dividends added to the S&P 500's average annual total return during each of the last seven decades. As seen in the last column, dividends added on average 3.4%, or 31% of the 10.9% annual average return of the S&P 500 from 1950 to 2018.

S&P 500 Total Return: Dividends vs. Capital Appreciation



Anchor's investment philosophy is to provide clients with above-market returns in down markets and competitive returns over the course of a stock market cycle. This approach is evident in every one of Anchor's strategies. Anchor's Select Dividend strategy, in particular, comprised only of dividend yielding stocks, takes this investment approach to its fullest extent. Anchor's strong preference for dividend yielding stocks reflects our commitment towards striving to provide clients with downside protection during periods of market volatility and to generate competitive long-term returns.

1. JP Morgan Guide to the Markets, 4Q18, page 9
2. https://www.morganstanley.com/ideas/four-sectors-dividend-growth
3. JP Morgan Guide to the Markets, 4Q18, page 34
4. Companies are grouped based on the 12/31/07 market yield: 1.8%. Source: FactSet financial data and analytics; summary
5. Data includes constituents of the Russell 3000 Index at year-end 2007. Source: FactSet financial data and analytics; summary
6. Total return for “No Yield” may differ from stock price change due to the introduction of dividends during the period; FactSet financial data and analytics; Total returns
7. Companies are grouped based on the 09/30/18 market yield: 1.7%. Source: FactSet financial data and analytics; summary
8. Data includes constituents of the Russell 3000 Index on 09/30/2018. Source: FactSet financial data and analytics; summary
9. Source: https://am.jpmorgan.com/us/en/asset-management/gim/adv/insights/guide-to-the-markets

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Dividends are not guaranteed and will fluctuate, dividend yield is only one component of performance and should not be the only consideration for investing. Common stocks do not assure dividend payments and dividends are paid only when declared by an issuer’s board of directors and the amount of any dividend may vary over time. Model transactions and holdings do not reflect individual portfolio activity for new account investments, or account activity and holdings in various individual portfolios subject to tax considerations or individual client discretion. Model performance may differ materially from individual client portfolio results.

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