ANCHOR
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## Executive Summary:

- Dividend-paying stocks have historically outperformed non-dividend paying stocks over many market cycles.[1]
- Dividend-paying stocks have a lower risk profile as these dividends tend to be supported by strong cash flows and outperformed non-dividend paying companies.
- Despite their attractiveness, dividend strategies have recently underperformed broader market indices. We examine the factors that have contributed to the underperformance.[2]
- We advise investors to be discerning when picking dividend strategies and recommend strategies where the risk of dividend cuts for underlying holdings is low.

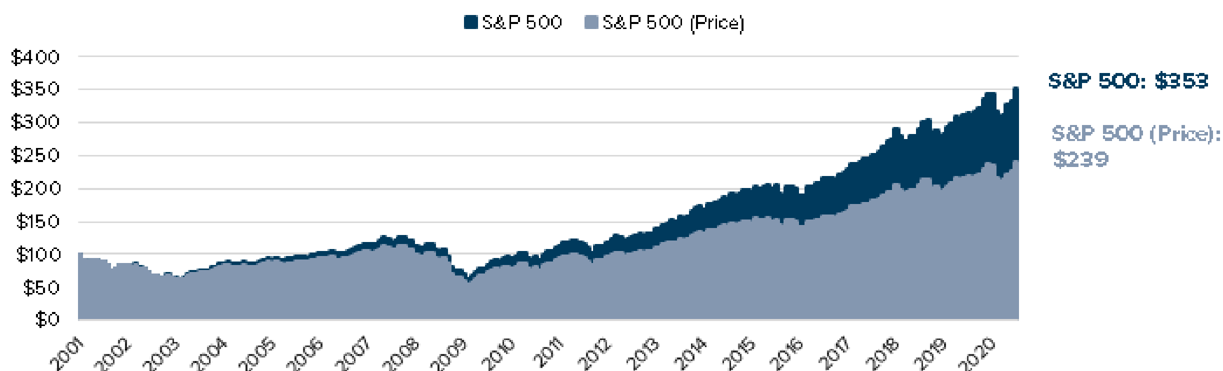
Traditionally, dividends have helped investors to gain reliable income and additional growth from their investment portfolios over time. However, equity-income strategies have been in focus in recent years as investors seek alternatives to low-yielding fixed income instruments, including treasury and investment grade bonds. In this paper, we look at these strategies, examining the historical returns as well as why we believe it makes sense to include them in investment portfolios.


# The Power of Dividends and Their Compounding Effect

Historically, dividends have been a key contributor to total returns over the long-term. Our analysis shows that if an investor were to have invested $100 in the S&P 500 Index in 1990, and reinvested all the dividends, the investment would today be valued at more than $6,500.[3]

### EXHIBIT 1:

### The Power of Dividends and Compounding Growth of $100 (February 2001 – July 2020)[4]




**Source:** eVestment Analytics

# Why Did Dividend Strategies Underperform During the Coronavirus Sell Off?

Over the past 20 years, the S&P 500 has experienced three bear markets with drawdowns greater than 30%.[12] Dot-com tech meltdown in 2001, financial crisis of 2008 and the current Covid-19 related global sell-off.

Dividend strategies outperformed broader markets during both 2001 and 2008 sell-offs. However, during the current crisis, most dividend indices underperformed. As an example, the S&P 500 Dividend Aristocrats index has underperformed the broader S&P 500 Index by almost 6 percentage points, year-to-date.

### EXHIBIT 6:

### Cumulative excess return of Dividend indices against S&P 500 Index[3]

| Drawdowns Total Return | S&P 500 Index | S&P 500 Dividend Aristocrats | S&P High Dividend Aristocrats | Down Jones U.S. Dividend 100 | Down Jones U.S. Select Dividend |
|---|---|---|---|---|---|
| Sep 1, 2000 – Oct 9, 2002 | -47.4% | 4.7% | 15.5% | 7.8% | 6.8% |
| Oct 9, 2007 – Mar 9, 2009 | -55.3% | -47.2% | -52.9% | -48.6% | -60.3% |
| Feb 19, 2020 – Mar 23, 2020 | -33.8% | -35.2% | -36.2% | -32.6% | -40.6% |

**Source:** S&P Global Research

# There are a Few Reasons For the Underperformance of Dividend Strategies So Far In This Current Crisis.

**First,** most dividend paying strategies are underweight in the Information Technology sector. The technology sector was a strong performer during the bull market and is so far outperforming during the current downturn. In our opinion, big tech companies are likely to remain unscathed and may even emerge stronger than ever – as they benefit from work-from-home, play-from-home and deliver-to-home tailwinds. As the table [Exhibit 7] shows, most dividend indices are significantly underweight in the technology sector when compared to S&P 500, thereby hurting returns.[13]

### EXHIBIT 7:

### Average sector exposure of dividend indices relative to S&P 500[14]

**December 31, 1999 – April 30, 2020**

| Sector Overweight/ Underweight | S&P 500 Dividend Aristocrats | S&P High Dividend Aristocrats | Down Jones U.S. Dividend 100 | Down Jones U.S. Select Dividend |
|---|---|---|---|---|
| Communication Services | -1.5% | -1.5% | -0.3% | -1.1% |
| Consumer Discretionary | 4.9% | -2.05% | -2.4% | -2.5% |
| Consumer Staples | 13.3% | 6.1% | 12.3% | -0.3% |
| Energy | -6.8% | -7.1% | 1.3% | -3.1% |
| Financials | -1.4% | 5.8% | -5.5% | 6.9% |
| Health Care | -1.2% | -6.3% | -3.3% | -10.2% |
| Industrials | 4.6% | 2.7% | 2.3% | -0.4% |
| Information Technology | -17.5% | -16.9% | -10.3% | -17.6% |
| Materials | 6.3% | 5.5% | 1.9% | 5.5% |
| Real Estate | -0.9% | 4.3% | -2.9% | -2.9% |
| Utilities | -0.4% | 13.2% | 4.5% | 23.2% |

**Source:** S&P Global

**Second,** the current sell-off is most likely driven by simultaneous shocks of the pandemic and the oil market collapse, which seems to have resulted in large energy companies looking for ways to preserve cash.

**Third,** atypical underperformance of the characteristically defensive utilities sector is driving current underperformance of dividend strategies.[15]

# Dividend Cuts Are On The Rise

Last, we believe the relative decline of dividend strategies suggests that investors seem to be anticipating significant dividend cuts or complete suspension of dividends, more so than during the previous two recessions.
While central banks' quick actions seem to have helped stabilize the financial markets, the steep drop in the global economy has put tremendous pressure on companies' cash flows. As a result, we are starting to see some companies either suspend dividends outright or reduce their dividend payments.

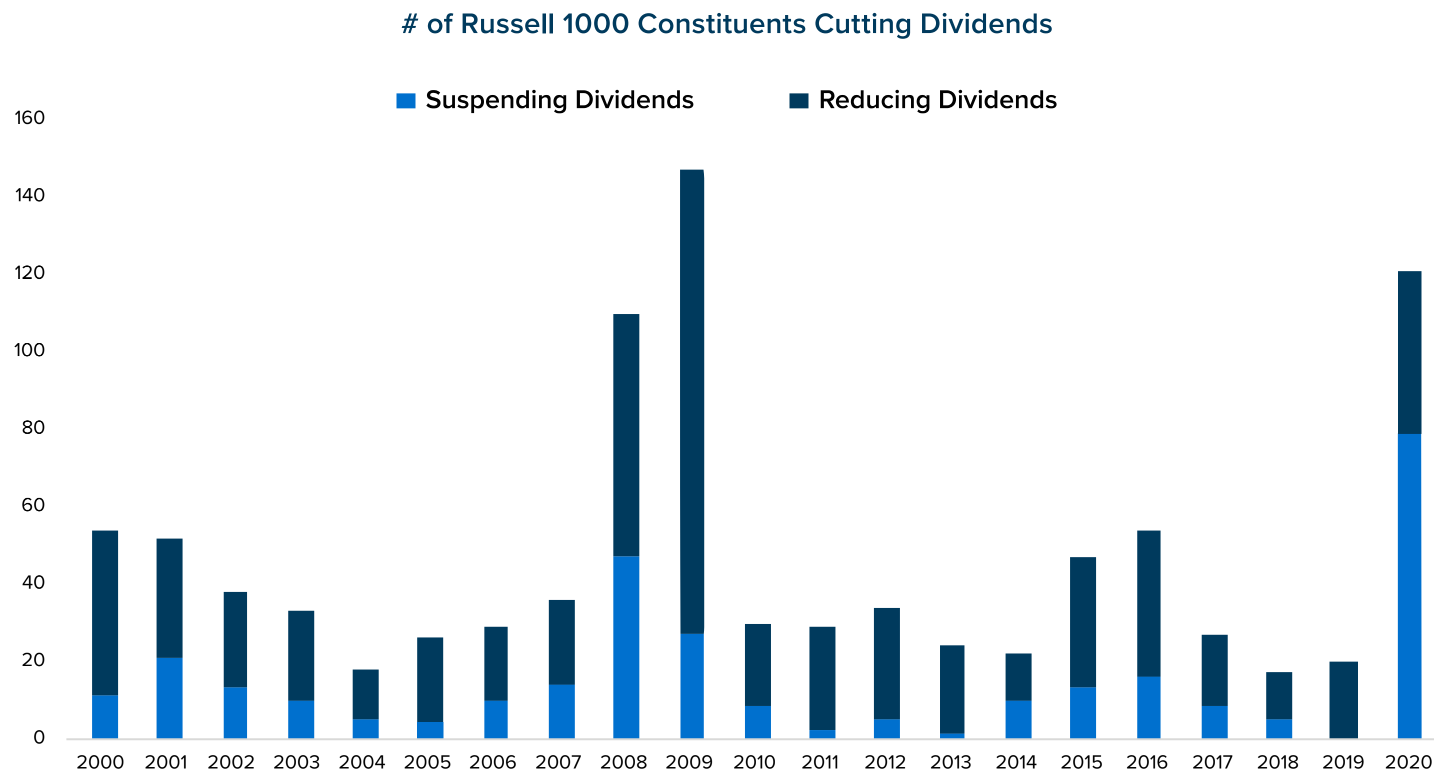
According to Morgan Stanley research, while the number of dividend reductions so far is still relatively small, the number of firms cancelling dividends altogether is already higher than in 2008.[16]

Most of the dividend suspensions and cuts appear to have come from industries that are most impacted by the current crisis: Consumer services (Hotels, Restaurants), Transportation (Airlines & Travel), Oil & Gas, and Capital Goods.

**EXHIBIT 8:**

**Rising dividend cuts[17]**

**June 4, 2020**




**Source:** Morgan Stanley Research