

Dividends for Offense and Defense

The Lead | May 2024

Relative Forward Price-to-Earnings (P/E) Ratio of High Yield Factor



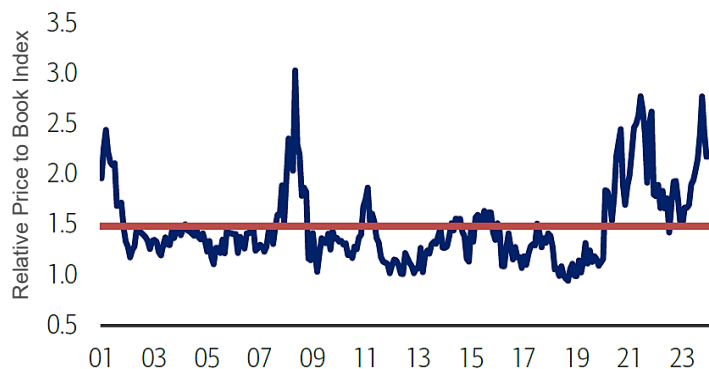
Source: BofA Global Research.

What could be a catalyst for dividend yielding equities in 2024? We shared in the past how dividend payers tend to outperform non-dividend payers 2-3 years after the first rate hike, but what tends to catalyze the improved performance?

Bank of America Global offered insight into the current set up for dividend paying stocks, and they make several points in favor of dividend payers. The first consideration is the relative value of dividend payers, notably the higher yielding dividend payers, as seen in the chart above. In the current environment, dividend yield is relatively inexpensive. While we have been through a period of 11 Federal Reserve (Fed) rate hikes and uncertain macroeconomic conditions, we believe companies that can pay a secure and growing dividend demonstrate the strength of an investment. As we have shared in recent months in our discussion of advantaged value, companies with these characteristics tend to have differentiated positions, possibly achieving strong market shares with the benefits of economies of scale and resilient balance sheets. They are typically able to play both offense and defense as the economy moves through uncertain times.

Within the context of the current period, dividend growth has performed better than high dividend yield, which may provide opportunities for dividend yield in 2024. Therefore, a second consideration are the relative opportunities within higher dividend yield relative to dividend growth, as seen in the following chart. We believe the Sterling Capital Equity Income strategy has observed and capitalized on this dynamic in real time, adding to high dividend yielding stocks while selling those with lower yields.

Dividend Growth versus Dividend Yield (Relative Price to Book Index)



Source: BofA Global Research.

Past performance is not indicative of future results. Any type of investing involves risk and there are no guarantees that these methods will be successful. Charts are for illustrative purposes only.



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12-Month Relative Performance versus S&P 500 Equal Weight Index After Positive Economic Surprises

Factor	Avg return	Median return	Hit rate
Dividend Growth	5.4%	5.2%	90%
Dividend Yield	13.0%	9.4%	80%
Price/ Free Cash Flow	5.7%	4.3%	80%
Price/ Sales	5.5%	5.2%	80%
EV/ EBITDA	6.5%	5.6%	80%
Price/ Cash Flow	3.3%	3.6%	70%
Free Cash Flow/ EV	7.7%	3.3%	70%
Relative Strength - 5wk/30wk MA	0.1%	1.9%	70%
Price Return - 3-mth Perf.	-0.7%	1.4%	70%
Low Price	2.9%	3.8%	70%
Share Repurchase	5.6%	5.2%	70%
Price Return - 12-mth and 1-mth Reversal	-0.3%	1.8%	60%
Most Active	-1.8%	1.4%	60%
Earning Momentum	-2.1%	0.8%	60%
Earnings Torpedo	5.6%	6.3%	60%
5y ROE	1.8%	2.3%	60%
Size	2.5%	2.4%	60%

EV/EBITDA: enterprise value/earnings before interest, taxes, depreciation, and amortization. ROE: return on equity.

Note: Based on top ten economic surprises since January 2000, according to the Bloomberg ECO Surprise Index. Source: BofA Global Research.

A third consideration (and potential catalyst) is the relative performance of dividend growth and dividend yield after positive economic surprises relative to other characteristics, shown in the table above. Our theory for the strong historic performance for dividend payers as economic growth picks up is twofold. First, because these companies tend to have more tangible results, investors tend to have more confidence from witnessing improved cash flow, earnings, and dividend growth in the recovery than the more speculative options. Second, as

interest rates fall with Fed rate cuts in an economic recovery, yield oriented investors reallocate from cash to high dividend paying equities.

Whether it is their relative valuations or the prospects for an improvement in economic conditions, we believe dividend payers have the potential to deliver.

As always, thank you for your interest and trust managing your investments.

Charles J. Wittmann, CFA®, Executive Director, joined Sterling Capital Management in 2014 and has investment experience since 1995. Chip is Co-Portfolio Manager of the Equity Income strategy. Prior to joining Sterling, he worked for Thompson Siegel & Walmsley as a portfolio manager and (generalist) analyst. Prior to TS&W, he was a founding portfolio manager and analyst with Shockoe Capital, an equity long/short hedge fund. Chip received his B.A. in Economics from Davidson College and his M.B.A. from Duke University's Fuqua School of Business. He holds the Chartered Financial Analyst® designation and served as President of CFA Society Virginia from 2012-2013.



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The volatility of an index varies greatly. All indices are unmanaged and investments cannot be made directly in an index.

The S&P 500® Equal Weight Index (EWI) is the equal-weight version of the widely-used S&P 500®. The index includes the same constituents as the capitalization-weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight - or 0.2% of the index total at each quarterly rebalance.

Dividend-focused strategies may underperform strategies that do not limit their investment to dividend-paying stocks. Stocks held strategy may reduce or stop paying dividends, affecting the strategy's ability to generate income.

Dividend Growing, No-Change-in-Dividend, and Dividend Cutting: Each dividend-paying stock is further classified into one of the three categories based on changes to their dividend policy over the previous 12 months. Dividend Growers and Initiators include stocks that increased their dividend anytime in the last 12 months. Once an increase occurs, it remains classified as a grower for 12 months or until another change in dividend policy. No-Change stocks are those that maintained their existing indicated annual dividend for the last 12 months (i.e., companies that have a static, non-zero dividend). Dividend Cutters and Eliminators are companies that have lowered or eliminated their dividend anytime in the last 12 months. Once a decrease occurs, it remains classified as a cutter for 12 months or until another change in dividend policy. (Source: Ned Davis Research).

Technical Terms: Dividend Risk: Dividend yield is one component of performance and should not be the only consideration for investment. Dividends are not guaranteed and will fluctuate. This report should not be regarded by the recipients as a substitute for the exercise of their own judgment. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager. **Dividend Yield:** a financial ratio that measures the annual value of dividends received relative to the market value per share of a security. In other words, the dividend yield formula calculates the percentage of a company's market price of a share that is paid to shareholders in the form of dividends. (Technical definitions are sourced from Corporate Finance Institute and Investopedia.)

The **Chartered Financial Analyst® (CFA)** charter is a graduate-level investment credential awarded by CFA Institute — the largest global association of investment professionals. To earn the CFA charter, candidates must: 1) pass three sequential, six-hour examinations; 2) have at least four years of qualified professional investment experience; 3) join CFA Institute as members; and 4) commit to abide by, and annually reaffirm, their adherence to the CFA Institute Code of Ethics and Standards of Professional Conduct.

Since we began publishing The Lead in 2015, our primary purpose has been to communicate our investment philosophy and process as an investment advisor in the context of changing markets. In creating portfolios that differ from our benchmarks by focusing on characteristics that have a long term history of attractive relative returns according to Ned Davis Research, the portfolios are different from the benchmarks and as a result there can be periods where results differ including below benchmark performance. Since strategies are oriented toward the long term characteristics, if those characteristics are out of favor over a period of time, the given strategy's performance could be challenged in terms of relative performance. While Sterling believes active professional investment management that employs a consistent process with a long term orientation and aligned with client interests offers benefits, management fees to support the active approach can be higher than certain alternatives. When hiring an investment manager we believe it is important to monitor the investment risks taken including sector concentrations, portfolio turnover, and the impacts of dividend policy changes.