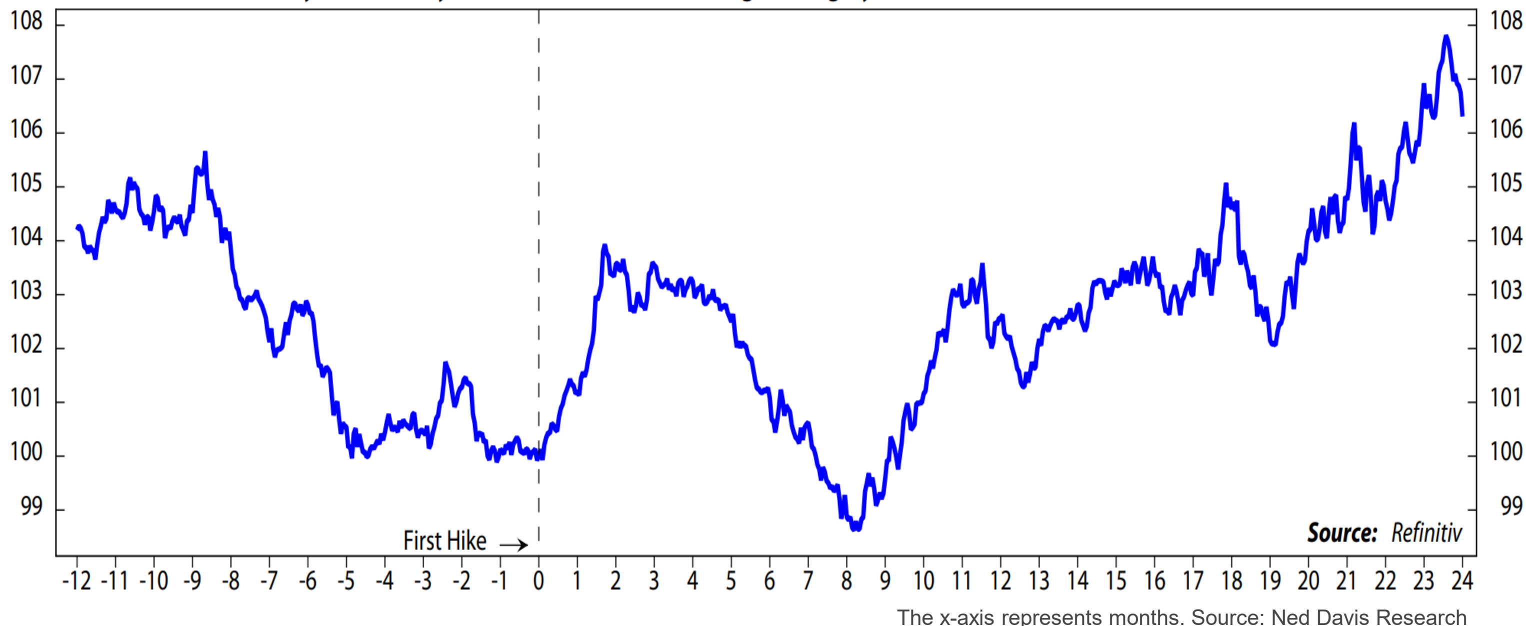
A Tried and True Game Plan

The Lead | April 2022

Payers > Non-Payers as Tightening Cycle Unfolds



The x-axis represents months. Source: Ned Davis Research

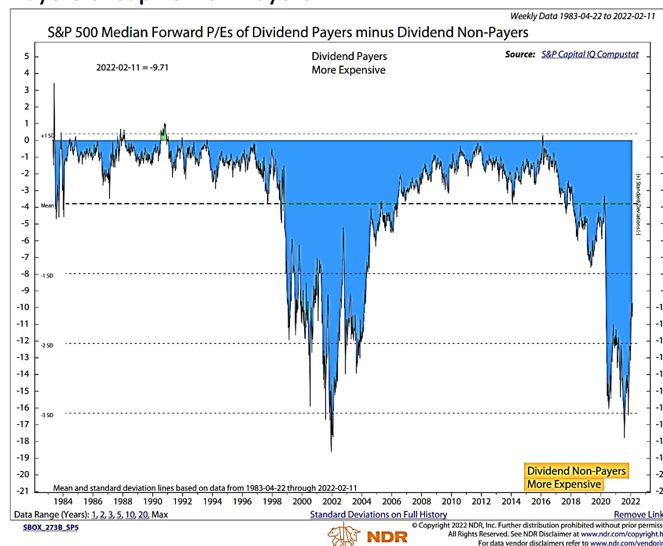
This year's NCAA men's basketball tournament was exciting and had the highest viewership in five years according to CBS. St. Peter's magical Cinderella run came to an end in the Elite Eight, demonstrating how difficult it is to run the gauntlet of competitive games and win a national championship. In the end, the Final Four was comprised of battle-tested college programs that cut down more than one championship net.

Our team loves an underdog in basketball, but when it comes to investing, we prefer a game plan that has demonstrated a propensity to win in the past. Last month, we discussed how dividend paying stocks began to outperform non-payers to start 2022. Investors see value in receiving current dividends that can be reinvested into higher interest rates should the Federal Reserve follow through on its expected rate increases this year.

Do dividend paying stocks have the ability to "run the gauntlet" of interest rate hikes? If so, what may be the best ones to own if we look back at prior rate tightening cycles? Ned Davis Research has looked at dividend payers and their performances from the time of the first rate hike. We provide the chart above that shows how dividend payers outperformed by over 6% and have done so 75% of the time going back to 1973.

While dividend payers tend to outperform non-payers in a rising rate environment, we'd note that in only one of the prior rate tightening cycles since 1973 have dividend payers been as attractively valued on a relative basis to non-payers. Combining a history of relative outperformance and compelling valuations could be two components of a game plan for success.

Payers cheap vs Non-Payers



Source: Ned Davis 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.

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Faster Dividend Growers Have Performed Well in Year Two of Interest Rate Tightening Cycle

S&P 500 Dividend High Growers/Low Growers Ratio Around Start of Tightening Cycle

The x-axis represents months. Source: Ned Davis Research

For over 20 years, we've believed as active managers that winning championships is not only about a good game plan, but also putting the best players on the court. For our Sterling Capital Equity Income strategy, that means not only owning dividend paying stocks, but those that we believe grow at a faster rate. Management boosting their dividend at a faster rate can signal optimism about their business in the future. It can be a measure of quality given a company's ability to pay dividends at a robust rate as well as a signal of management's alignment with shareholders. As seen above, historically using the same Ned Davis Research methodology, these high growers outperformed low growers close to 7% 24 months after the first rate hike, 71% of the time. With a strategy holding attractively valued companies that not only pay dividends but are growing them at a higher rate, this appears to be a game plan that can help our clients succeed in the end.

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 Global Leaders strategy and associate 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. Chip earned the Certificate in ESG Investing, which is developed, administered and awarded by the CFA Society of the United Kingdom. He holds the Chartered Financial Analyst® designation.

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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® Index is a readily available, carefully constructed, market-value-weighted benchmark of common stock performance. Currently, the S&P 500 Composite includes 500 of the largest stocks (in terms of stock market value) in the United States and covers approximately 80% of available market capitalization.

Dividend Policies: Dividend Paying vs. Non-Paying: Each stock's dividend policy is determined by its indicated annual dividend. We classify a stock as a dividend-paying stock if the company indicates that it is going to be paying a dividend within the year. A stock is classified as a non-payer if the stock's indicated annual dividend is zero. Prior to July 2000, the indicated annual dividends were updated on a quarterly basis. Since July 2000, the indicated annual dividends are updated on a daily basis, so the most up-to-date information is used. The index returns are calculated using monthly equal-weighted averages of the total returns of all dividend-paying (or non-paying) stocks. A stock's return is only included during the period it is a component of the underlying index. The dividend figure used to categorize the stock is the company's indicated annual dividend, which may be different from the actual dividends paid in a particular month. **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.)

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