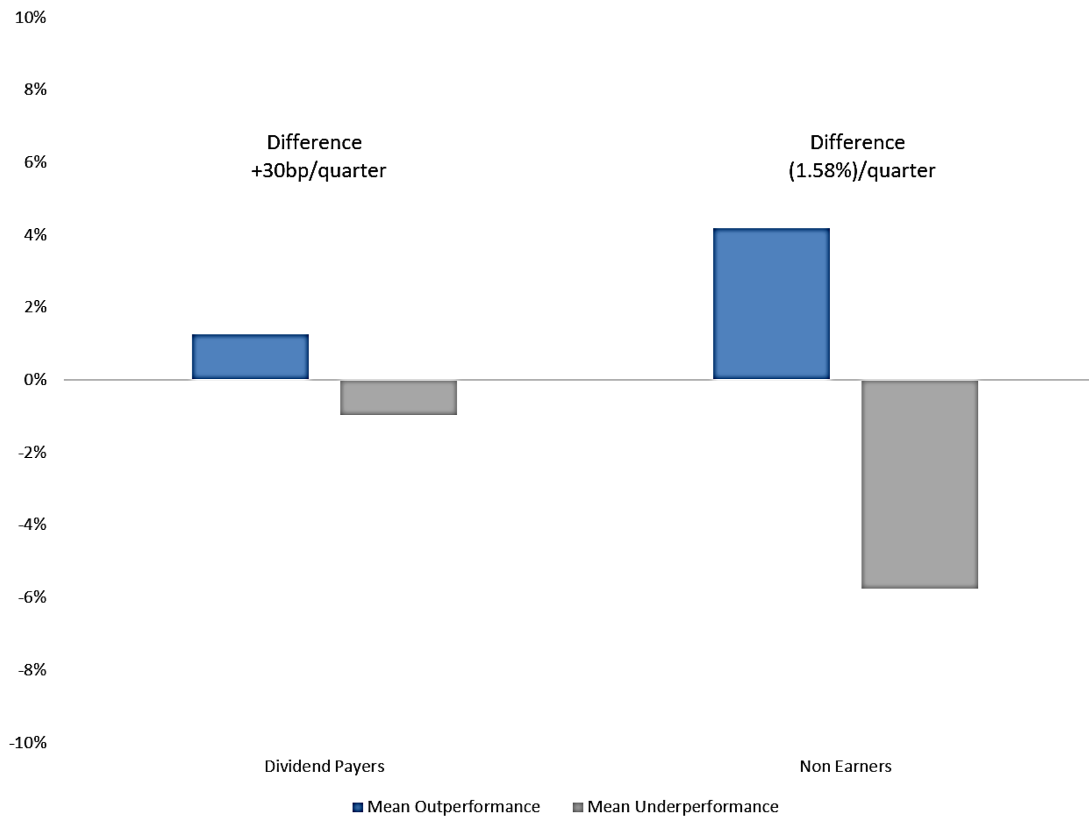
Long-Term Dividends

The Lead | August 2023

Twenty Year Quarterly Performance Table Relative to the Russell 1000® Value Index



Equally-weighted returns rebalanced quarterly. Source: Bloomberg L.P.

The top-performing stock in the Russell 1000® Value Index has not made a profit over the past twelve months. According to Bloomberg L.P., analysts are forecasting the company will not generate a profit until 2027. At the same time, 2023 has been a challenge for dividend-paying stocks. In the past, we discussed the benefits of owning dividend-paying and dividend growth stocks, but why may dividend stocks underperform during certain periods? What are the investing environment conditions that can cause dividend payers to lag on a short-term basis?

We know that dividend payers provide value in the short term because their dividend payments provide cash in the hands of investors, typically on a quarterly basis. That value can be consumed or reinvested. The relative certainty of receiving a steady stream of cash payments can also represent lower risk, especially when dividend payments are received steadily throughout the year.

What's the relationship between dividend payers that are returning value now versus companies that generate losses now in the hopes of producing profits and value in the distant future? We believe a good way to measure this dynamic is through the relationship between dividend payers and companies we refer to as non-earners, or companies that have not earned a profit over the past year.

To the extent these companies can outperform the benchmark during certain periods, it can be a sign that investors are willing to fund their loss-making enterprises in the hopes of profiting down the line. As seen by the chart on the next page, this year, non-earners in the Russell 1000 Value have outperformed the dividend payers, according to Bloomberg L.P.

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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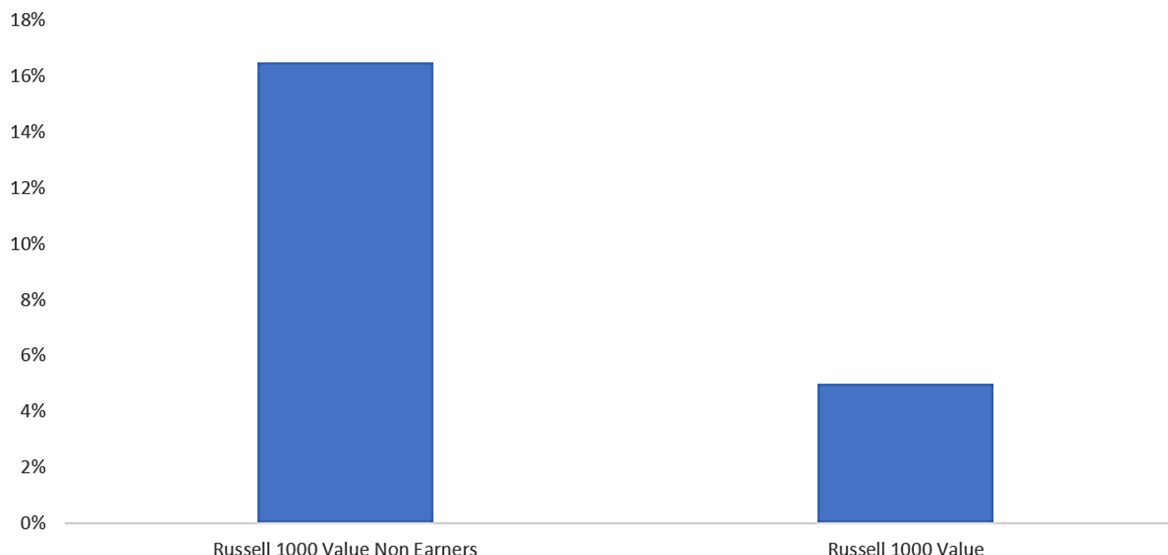
Russell 1000 Value Unprofitable Company Total Returns versus Benchmark (1H23)



Russell 1000 Value Non-Earners include 124 securities based on net income and are equally weighted. Source: Bloomberg L.P.

Looking back at Bloomberg data over the past twenty years, when dividend payers outperformed the Russell 1000 Value, non-earners underperformed and vice versa (56% of the time). While the dividend payers and non-earners tend to move in opposite directions, assessing data over short time periods can be misleading. Over the twenty year period, dividend payer's quarterly outperformance outweighed underperformance in contrast to non-earners, as seen in the chart on the previous page. We believe the ability to compound overall gains versus losses represents an aspect of dividend payer performance that could lead to a long-term performance pattern.

In our quest to generate above-average returns with below-average risk for our clients, our approach is to take advantage of the long-term benefits of dividend payers that grow their dividends and seek to create value now and in the future.

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. 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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Important Information

Disclosures

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

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.

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).

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. _

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