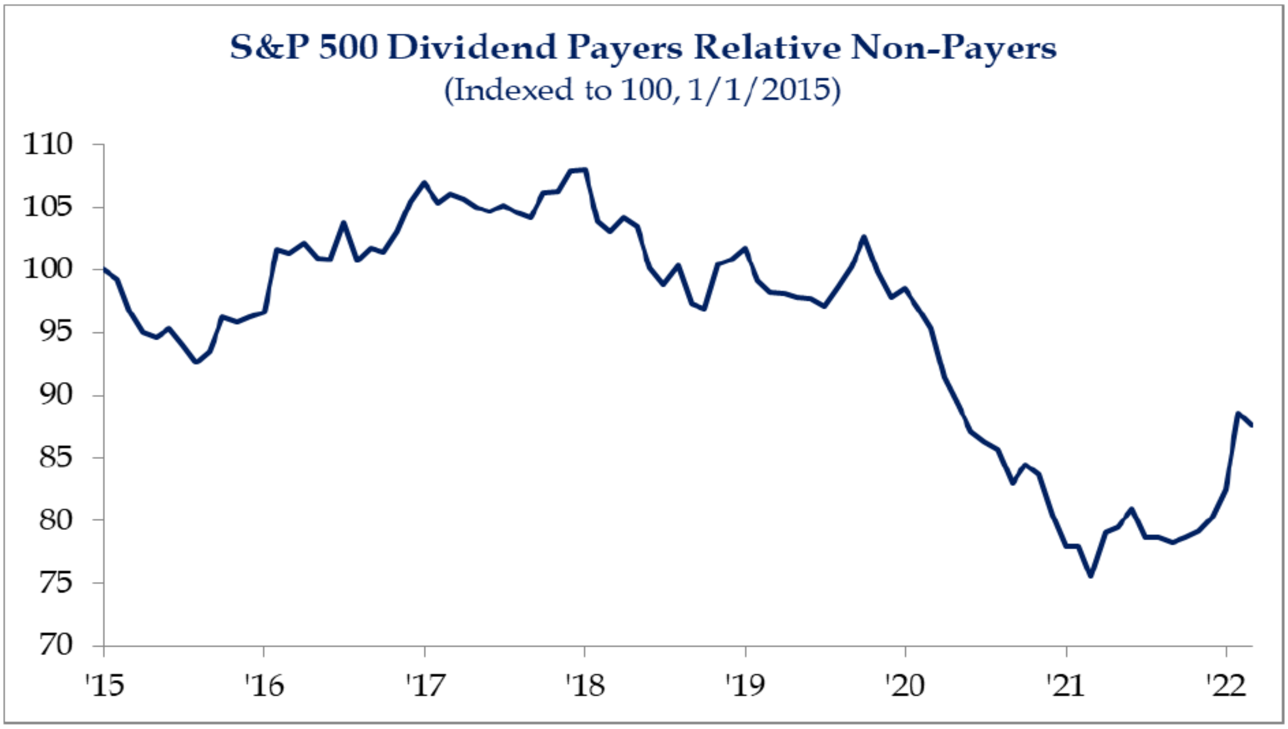
Dividends Valued in 2022

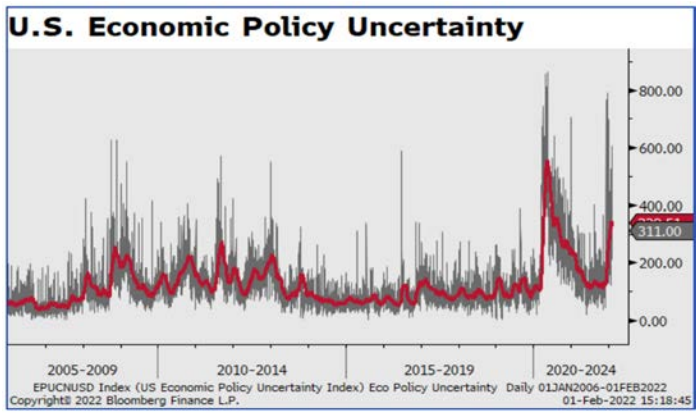
The Lead | March 2022



Source: Strategas

Dividend payers have experienced a strong start in 2022 relative to non-divided paying stocks. There are a number of reasons for this change, as it coincided with the record hawkish shift in the Federal Reserve's dot plot projections for future federal funds rates and the increased economic policy uncertainty, as shown in the Bloomberg chart to the right.

The prospects for higher inflation and short-term interest rates have reintroduced the concept of equity duration written about in a 2011 research paper by David Schroeder of Birkbeck, University of London. The duration of a stock is a complex formula that assesses a stock's expected long-term growth rate, implied earnings growth, valuation on a price-to-revenue basis, and dividend and cash flow yield. Long duration equities are highly sensitive to interest rates, changes in the cost of capital, and forecasted future cash flows. Short duration equities tend to trade at high current free cash flow yields due to their relatively uncertain cash flow generation and influence of interest rates. In recent years, long duration equities that are not dividend payers have outperformed. Their belief was that market participants believed low interest rates would continue, providing these companies with highly predictable cash flows. That world view appears to have changed.



Source: Bloomberg

As Empirical Research noted this month, stocks in their long duration cohort (with 2024 estimated earnings yields between zero and 1.6%) "lagged the market by more than (30) percentage points," while "stocks with above-median yields, that are 5.7% or higher, have led by more than +8 points." In other words, stocks that are providing value today are outperforming those that may in the distant future.

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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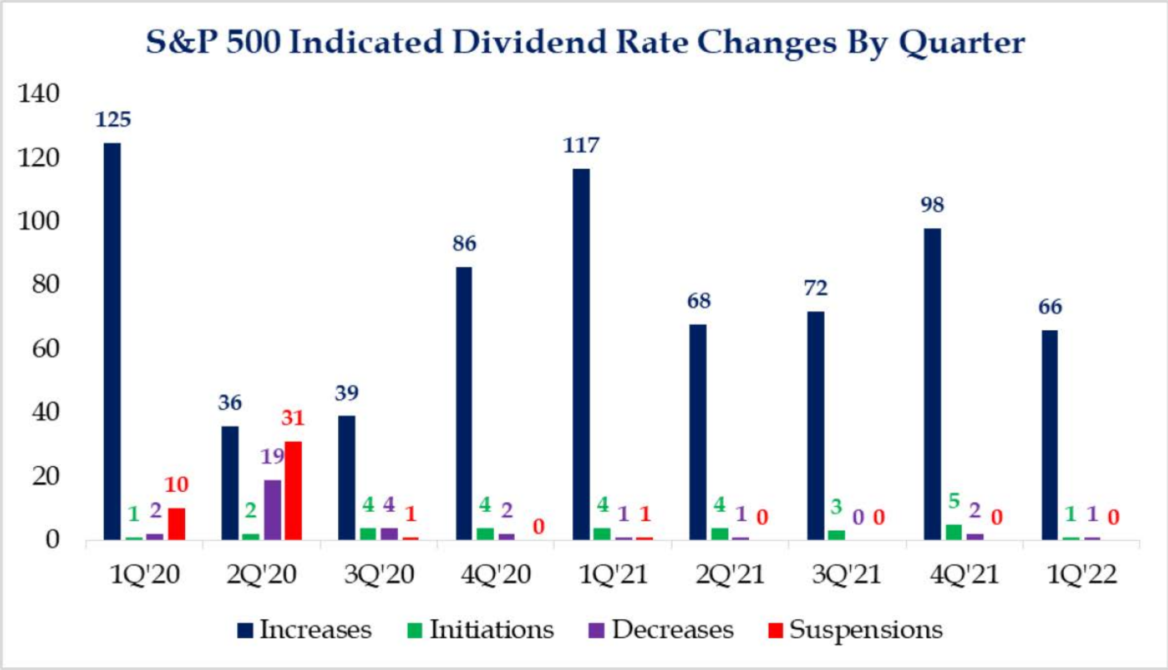

Source: Strategas

What do we mean by value? First, with higher economic uncertainty regarding the number of future interest rate hikes and reduced confidence in the predictability of corporate earnings in the future, stocks with lower valuations that also pay current cash dividends can offer greater value. Second, stocks that are providing investors with current cash flows and the receipt of dividend payments also enable investors to reinvest dividends at potentially higher near-term yields rather than navigating years of uncertainty for a potential payoff.

Within the Sterling Capital Equity Income strategy, we believe clients can benefit from both near and long-term value creation. Both include the receipt of current dividends that are growing at a double-digit rate on a portfolio basis versus the slowing dividend growth rate in the S&P 500 seen above. We believe they also benefit from the value our holdings are building through their market leadership positions and financial strength. This not only helps to pay dividends now, but may also help to invest in their growth initiatives to create value in future decades as well.

As always, thank you for your interest and trust in 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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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.

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. **Free Cash Flow (FCF)**: measures a company's financial performance. It shows the cash that a company can produce after deducting the purchase of assets such as property, equipment, and other major investments from its operating cash flow.(Technical definitions are sourced from Corporate Finance Institute and Investopedia.)

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