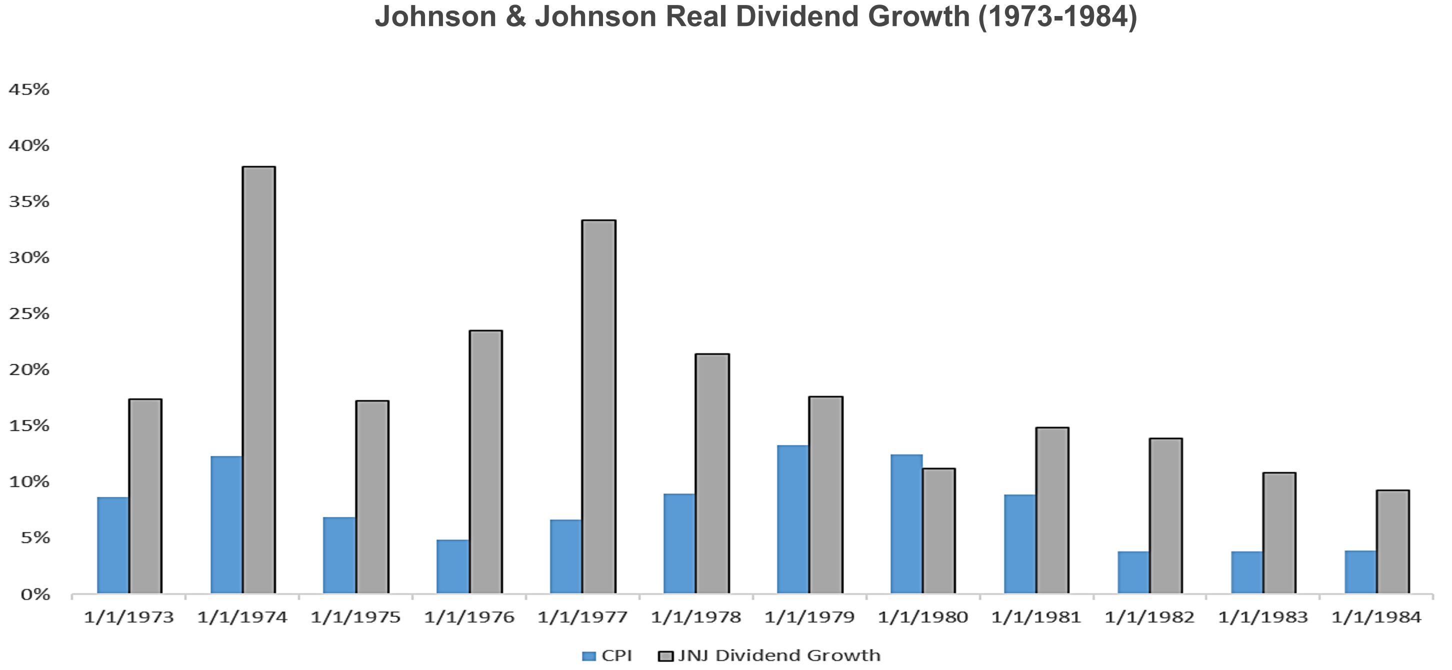
"Real" Dividend Growth

The Lead | May 2022



Source: Bloomberg

Over the last several months, we have shared with investors how stocks with growing dividends have tended to outperform during periods of rising interest rates using Ned Davis Research data. In calls this month, clients asked how dividend growers perform during periods of higher inflation specifically. One challenge in answering the question is whether this inflation cycle is similar to ones we have experienced over the past 30 years.

In the chart on the right, we provide a historical context for the annual dividend growth of 'the market' and the rate of inflation. As one can see, in most decades, dividend growth handily outpaces the rate of inflation. These comparisons become challenging during certain periods that can last for an extended period of time, notably during the 1970s.

We wanted to go back in history to the early 1970s and revisit the lines Americans had to endure to fill up their cars at gas stations during the oil crisis in October 1973. The early 1970s and early 1980s saw periods of high actual inflation.

While the data on the table provides dividend growth for 'the market', we also know that many high quality, market-leading companies can grow their dividend at a higher rate than inflation over most time periods.

What we found interesting when we looked back at one of our current Sterling Capital Equity Income holdings, Johnson & Johnson, was how they were able to grow their dividend during this time period. At the time, their business was balanced between mass consumer products and specialized professional products, with no product comprising more than 5% of total revenues. During the 1970s, the company emphasized its consumer products heavily with pain reliever Tylenol, for example, becoming its highest revenue product. What may be surprising is the strength of the company's fundamentals and commitment to dividend growth that fueled annual dividend growth ahead of the rapid increases in inflation in virtually every year during this time period.

S&P 500: Dividend Growth Rate By Decade

Decade	Total Growth	Annual Growth	Inflation Rate
1950s	60.5%	4.8%	2.0%
1960s	72.7%	5.6%	2.3%
1970s	78.8%	6.0%	7.1%
1980s	95.6%	6.9%	5.5%
1990s	49.1%	4.1%	3.0%
2000s	36.0%	3.1%	2.6%
2010s	93.6%	6.8%	1.7%

Source: Robert Shiller Data

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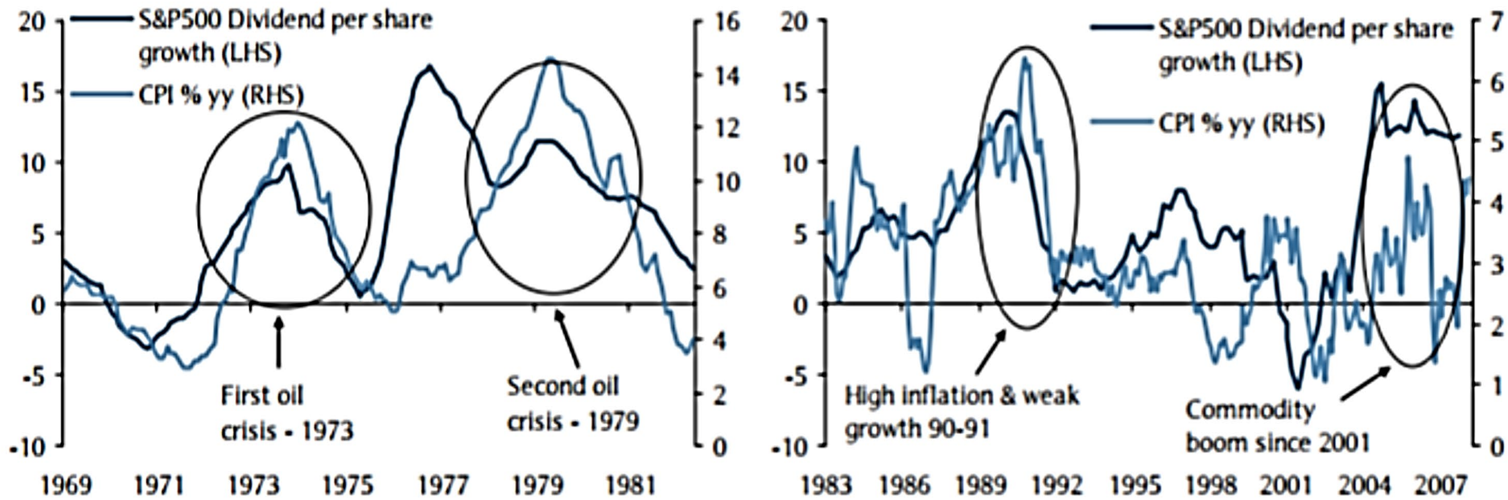
U.S. Annual Inflation Rate and S&P 500® Dividend Growth



Source: Ecowin

The charts above take another look at the ability of stocks to raise their dividend growth rates ahead of inflation during inflationary environments. We believe an important component in assessing who can outpace inflation with higher dividend growth rates is finding companies such as Johnson & Johnson with strong brands that provide essential and mission-critical goods and services. Their position can offer pricing power that translates into increasing cash flows that are reinvested in the business as well as rewarding shareholders with dividend growth ahead of inflation. ‘Real’ dividend growth from market-leading companies in the past may provide an important perspective in the future.

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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).

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