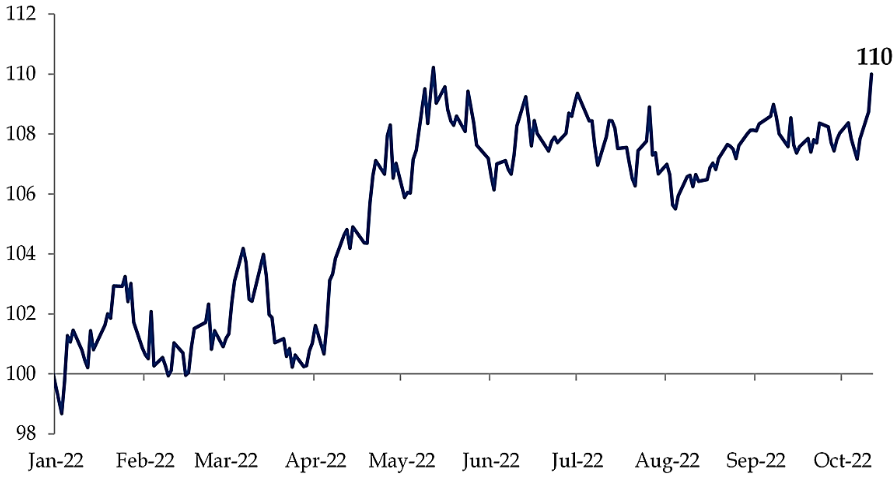
Dividends Distinguishing Themselves

The Lead | November 2022

S&P 500 Dividend Aristocrats Relative to S&P 500® Index



Sources: FactSet; S&P Dow Jones Indices; Strategas.

A few months ago, a mint condition Mickey Mantle baseball card from 1952 sold for a record $12.6 million. It was the most amount of money ever paid for a piece of sports memorabilia. His career contributions were both on offense with 536 home runs and batting .300 more than ten times while also distinguishing himself as a great fielder with a .984 fielding percentage. During his career, he won the Most Valuable Player three times, and the Yankees won seven World Series with Mantle on their team.

When seeking to win championships, having players with consistent track records of playing both offense and defense can be valuable. Thus far in 2022, it appears stocks with strong track records of paying higher dividends are valuable when the stakes are high. The chart above shows the relative outperformance of stocks that have increased their dividends for 25 consecutive years or more. At present, there are 64 companies that meet this criteria. Relative to ‘the market’, they are providing offense in terms of relative performance, and defense in terms of capital preservation with equity markets posting negative returns year-to-date. We are attracted to these companies and their ability to generate cash with little to no need to tap the capital markets to fund their strategic objectives. One of the performance challenges for this passive portfolio in 2022, however, has been its significant exposure to the economically sensitive industrials sector, where its exposure sits at roughly twice the sector weight of the Russell 1000® Value Index.

As active managers, we find a benefit of owning dividend aristocrats. Our Sterling Capital Equity Income strategy owns ten aristocrats, but spreads them out with other proven dividend payers to gain the benefits of diversification. The table below from Ned Davis Research highlights how dividend payers as a whole and across each sector performed during the market decline in the first half of the year. The leadership was widespread as dividend payers outperformed by +16.7% during this time period.

Payers > Non-Payers during 1H22 decline

Dividend Payers vs. Non-Payers
By S&P 500 Sector (12/31/2021 - 6/16/2022)

Sector	Payers (%)	Non-Payers (%)	Pay - NP (%)	Payers Count	Non-Payers Count
Energy	42.0	0.0	42.0	21	0
Communication Services	-12.5	-34.3	21.7	13	13
S&P 500	**-15.3**	**-32.0**	**16.7**	**396**	**108**
Health Care	-14.2	-29.8	15.6	40	24
Utilities	-5.4	-14.9	9.5	29	0
Financials	-18.7	-27.2	8.4	64	2
Real Estate	-23.7	-31.5	7.8	30	1
Information Technology	-24.9	-32.7	7.8	43	33
Consumer Discretionary	-30.2	-37.1	6.9	36	24
Industrials	-19.6	-25.7	6.1	61	10
Consumer Staples	-6.1	-8.5	2.4	31	1
Materials	-13.0	0.0	-13.0	28	0

Payers = S&P 500 stocks with indicated annual dividend yields >0. Non-Payers = indicated annual dividend yield = 0. All indices are equal-dollar weighted and total return. Energy, Materials, and Utilities had no Non-Payers for the time period.
Sources: S&P Capital IQ Compustat and S&P Dow Jones Indices.

Source: Ned Davis Research.

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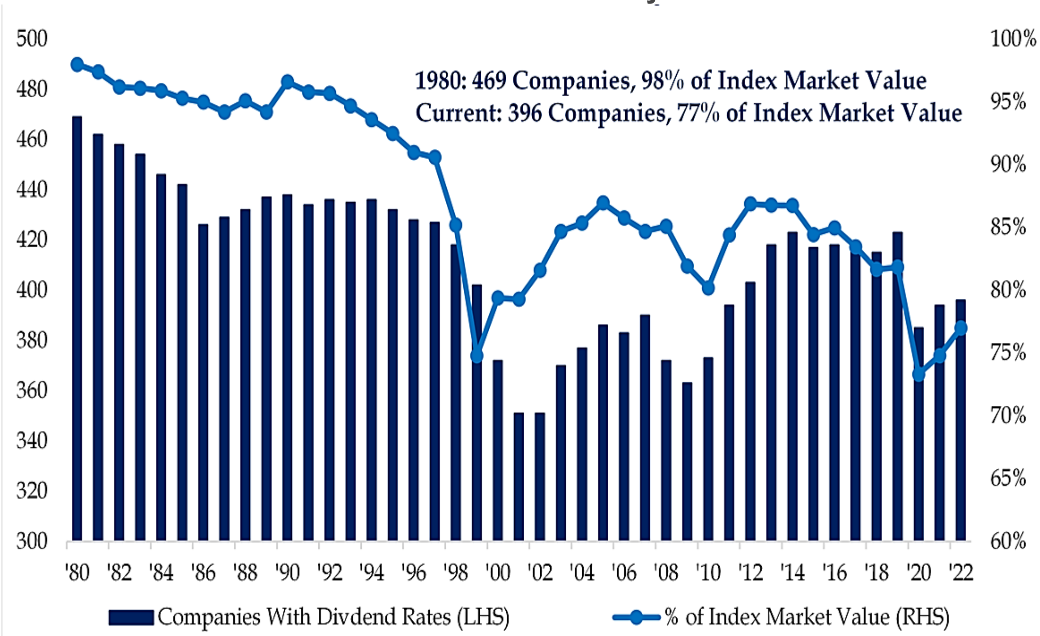
S&P 500 Dividend Players



Sources: S&P Dow Jones Indices; Strategas.

While not every business has the strength and durability to increase their dividends for 25 years or more, given the attractive dynamics in protecting shareholder capital in 2022, one might think more companies would reward their shareholders with dividends, but the opposite has occurred. Strategas notes that since 1980, the percentage of stocks in the S&P 500 paying dividends has declined from 98% to 77%. This trend can be seen in the chart above in the right y-axis.

When endeavoring to build a championship in the Equity Income portfolio, we select not only from companies that reward shareholders with dividends across economic sectors, but also from those that have distinguished themselves through a track record of growing their dividends to create value.

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 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.
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 Russell 1000® Value Index measures the performance of the large cap value segment of the U S equity universe It includes those Russell 1000 ® companies with lower price to book ratios and lower expected growth values The Russell 1000® Value Index is constructed to provide a comprehensive and unbiased barometer for the large cap value segment The index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect value characteristics.
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.)
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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