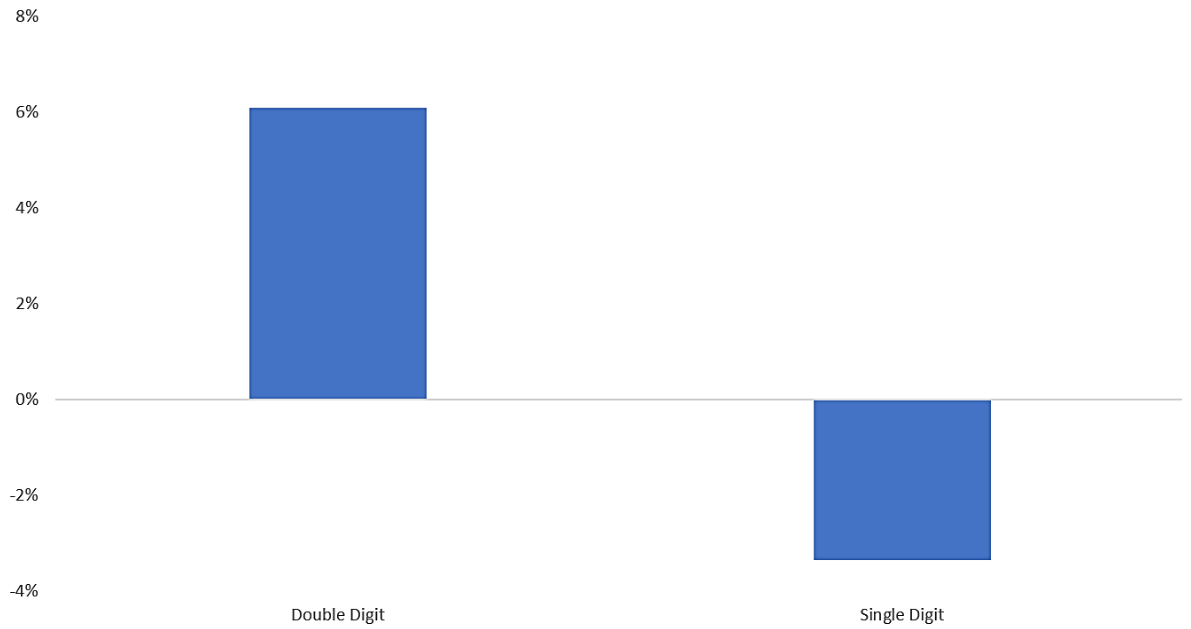
Rising Tide

The Lead | October 2023

S&P 500® Total Return by Dividend Growth

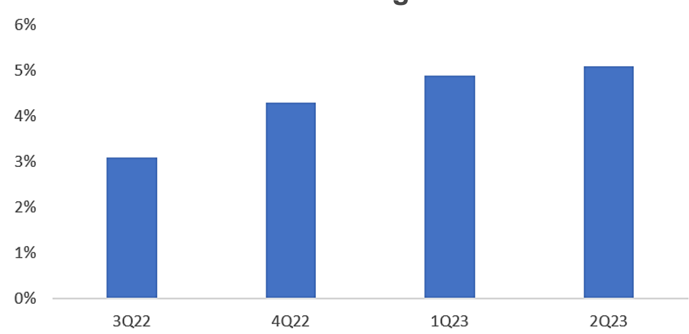


S&P 500 stocks grouped by one year dividend growth rate. Source: Bloomberg L.P. Total Return year-to-date as of 09.27.2023.

The college football season got into full swing last month. As more games are played, fans gain a greater appreciation for how well their teams prepared in the off season. From the time the whistle blows to start the game until the final whistle to end the game, the true merits of the strengths and weaknesses of a team are revealed on the scoreboard.

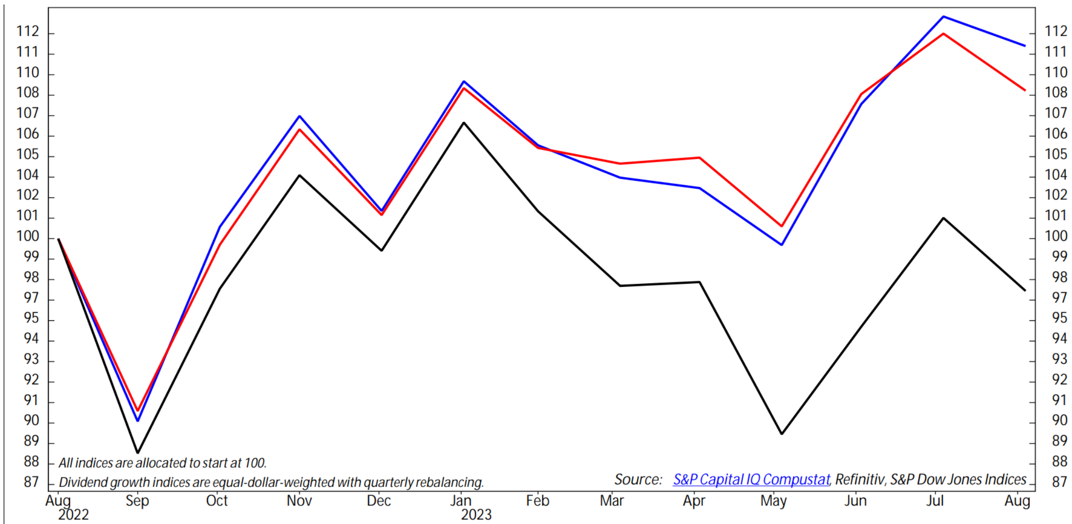
For the stock market so far this year, it has been a winning story in terms of absolute return in our opinion. When we are asked about how to think about balancing dividend growth and dividend yield, we believe both are important, but over long periods of time, dividend growth has tended to outperform dividend yield, according to Ned Davis Research. We would note that the same is true this year and show in the chart above how stocks with double-digit dividend growth have provided positive returns in 2023 versus negative returns for single-digit growers. In the current environment, companies face higher wage and margin pressures, higher interest rates (as seen in the chart below), and recently, high energy prices. In a period combining all three of these challenges, higher dividend growers are being rewarded in part for their ability to return more cash to their shareholders than slower growth peers.

Fed Funds Target Rate



Midpoint in %. Source: Bloomberg L.P.

Returns of Highest Dividend Yielding and Largest Dividend Growing S&P 500 Stocks (Monthly 08.31.2022 – 08.31.2023)



Last 1 year(s) Statistics

Strategy	GPA (%)	Sharpe Ratio	Max Draw Down (%)	Downside Deviation (%)	Standard Deviation (%)	% Monthly Returns >0	Last Month's Return (%)
— Largest Growers	11.42	0.30	-9.76	12.29	22.44	41.67	-1.65
— S&P 500 Equal-Weighted Total Return Index	8.67	0.19	-9.23	11.97	20.93	50.00	-3.16
— Highest Yielders	-2.90	-0.31	-16.07	16.44	24.32	50.00	-4.02

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NDR

Source: Ned Davis Research.

It is interesting to note that the largest growers are also outpacing high yielders in 2023, as seen in the blue line in the chart above. As we shared last month, there is a high correlation in the Russell 1000® Value Index between high yields and high debt levels.

In the midst of higher cost of capital and interest rates, we believe owning quality companies that earn returns on capital well above their cost of capital have the potential do well in this new environment. In addition, strong balance sheets and low debt levels often protect earnings and dividend growth from rising interest rate costs. Thankfully, these two characteristics comprise two of our four investment pillars that we have utilized for over twenty years, which employ in our effort to place our clients in an advantaged investment position.

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 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).

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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