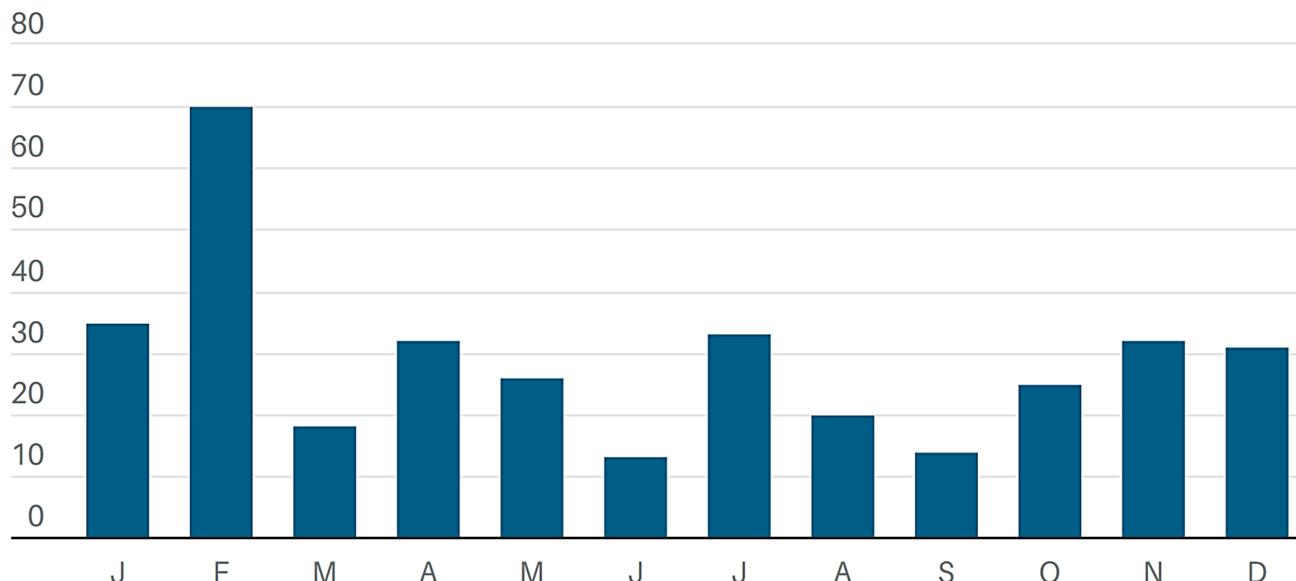
Receiving Dividends

The Lead | September 2022



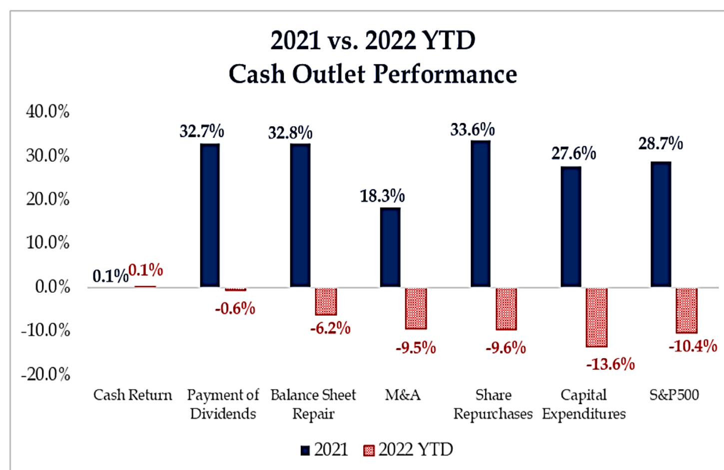
S&P 500 monthly averages from the data date back to 2014.
Source: S&P Dow Jones Indices.

We have been writing about how paying regular dividends to shareholders can be a method that company owners can hold management teams accountable for the stewardship of their capital. We found the above chart highlighted in an article in this month's Barron's magazine interesting on this front.

Why is the shortest month of the year, February, the biggest month for dividend declarations? One theory is that it is because companies have closed the books on the year and know their financial position. However, companies close their books every quarter and hold conference calls with investors to provide them with an update on operations. With dividend declarations throughout the year, there are plenty of companies that declare dividends at times other than after year-end results.

We prefer the theory that February is right before proxy season and that spring is the most popular time for annual meetings, when company managements have to sit in front of their owners and provide an update on last year's results and ask for shareholder votes, including ones on their compensation packages. What better time to increase a company's dividend than right before management has to meet the shareholders?

We encourage the payment of dividends for those companies with excess capital, especially as rising rates make shorter duration assets (those that enable investors to hedge the impact of inflation by returning cash in the near term so investors can reinvest). Year-to-date, Strategas notes that companies returning cash in the near term by paying dividends, buying back shares, and repairing their balance sheets have performed well.



Source: Strategas.

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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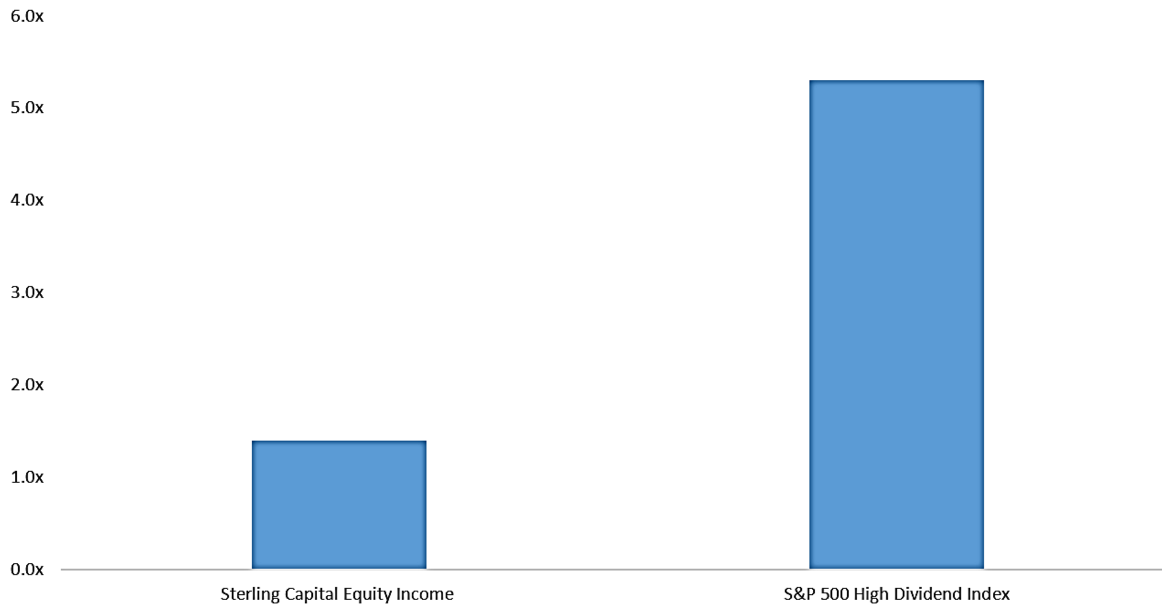

Sources: Sterling Capital Analytics; Bloomberg L.P. Data as of 06.30.2022.

While we like receiving dividends, we do not want companies to make those payments to the detriment to the long-term financial health of the enterprise. A high dividend yield does not necessarily connotate financial health. Companies in trouble sometimes attempt to attract market participants by going into debt to pay shareholders. In the chart above, we contrast the higher debt on the balance sheets of high dividend payers versus the Sterling Capital Equity Income strategy. We believe finding companies that can pay a dividend yield above 'the market' while growing it consistently and funding that increase through organic growth rather than putting their balance sheet at risk is an attractive combination in creating high conviction portfolios for clients.

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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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: **EBITDA** stands for Earnings Before Interest, Taxes, Depreciation, and Amortization and is a metric used to evaluate a company's operating performance. It can be seen as a loose proxy for cash flow from the entire company's operations. **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.

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