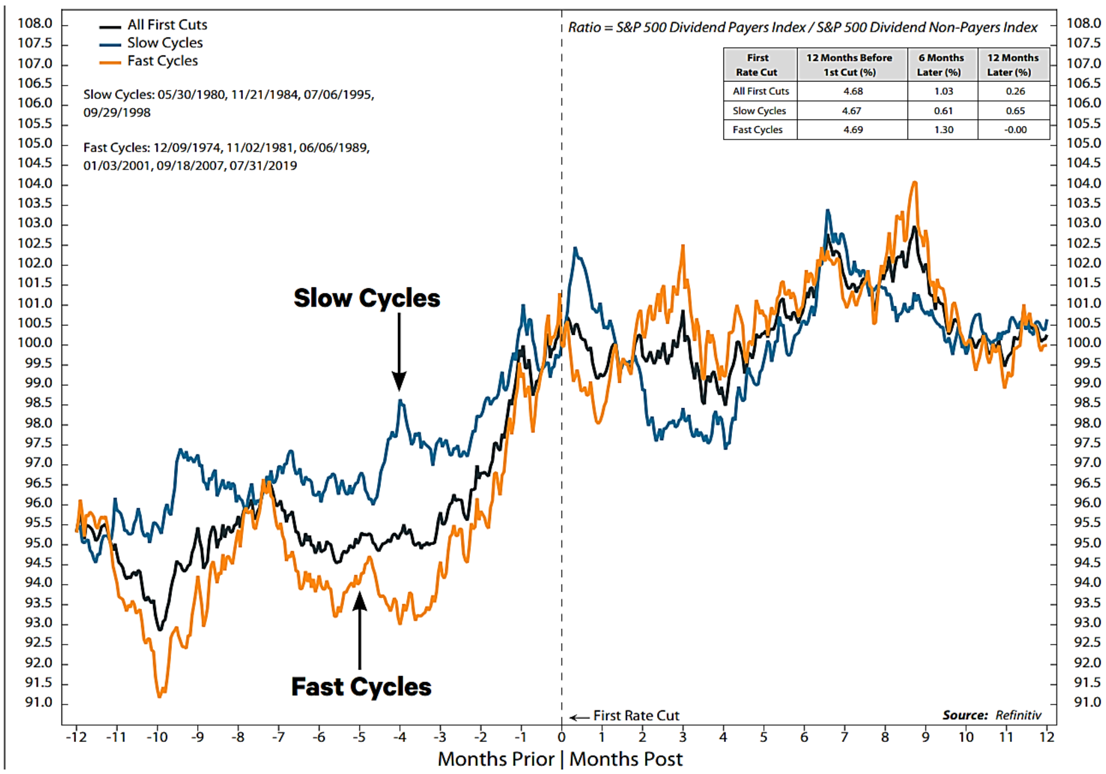
Dividend Opportunities

The Lead | September 2024

Dividend Payers versus Non-Payers After the First Federal Funds Rate Cut



Source: Ned Davis Research.

As we enter September, it appears the Federal Reserve (Fed) is prepared to lower the federal funds rate at their September 18, 2024 meeting. Bloomberg federal funds futures indicate there is a 100% probability of one rate cut, with the potential for the cut to be more than just 25 basis points. We have previously written about the performance of dividend payers after the first rate hike and now we appear to be coming full circle to rate cuts. How do dividend payers perform, and how can investors best position their portfolios to try and take full advantage of the potential change in the investing environment?

Historically, dividend payers have outperformed non-dividend payers after the first cut (note the chart above). There are some potential reasons for this outperformance. The first is that dividend payers can benefit from less competition from bonds as their yields decline.

Second, if the Fed cuts rates, it has typically been a sign of slowing economic growth and the defensive nature of dividend payers can shine in that type of environment. In the chart above, Ned Davis Research segments their analysis by the pace of cuts, with faster cuts (orange) required to avoid recession and a slower pace (blue) in a soft landing environment. Regardless of the pace, dividend payers tend to outperform after the first cut.

Fast Dividend Growers to High Yielder Ratio

First Rate Cut	12 Months Before 1st Cut (%)	6 Months Later (%)	12 Months Later (%)
All First Cuts	-0.12	2.35	1.28
Slow Cycles	0.57	9.43	1.98
Fast Cycles	-0.58	-2.37	0.81

Source: Ned Davis Research.

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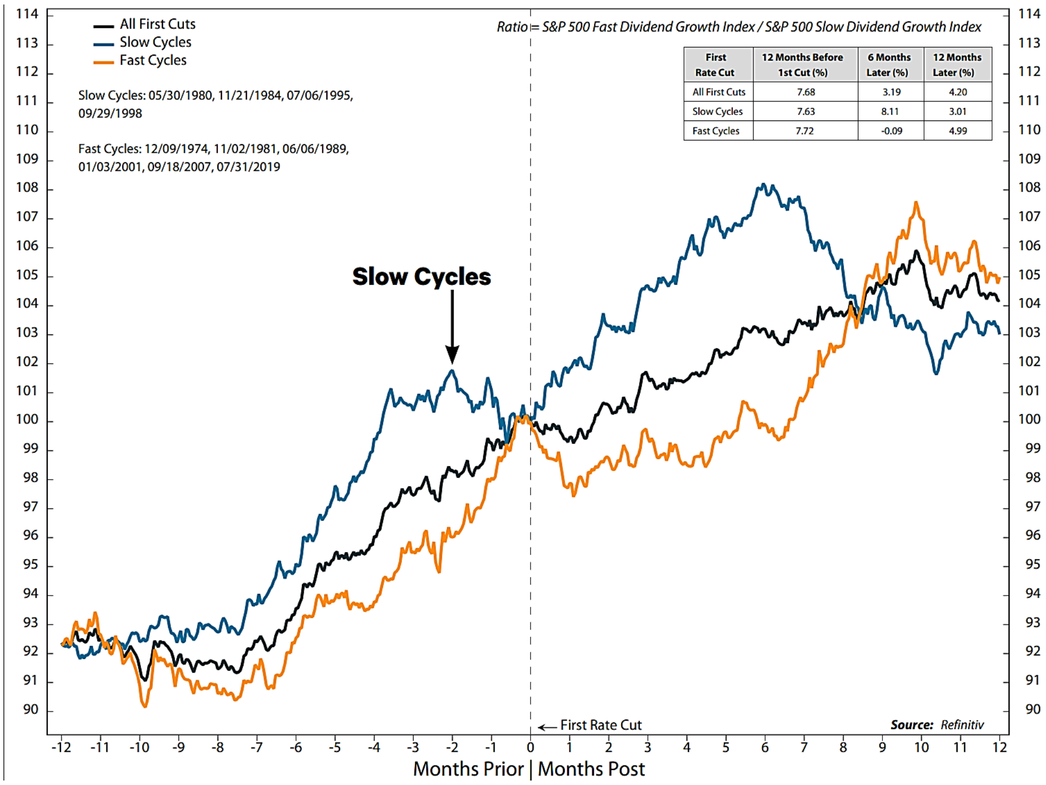
Fast Dividend Growers versus Slow Growers After First Federal Funds Rate Cut



First Rate Cut	12 Months Before 1st Cut (%)	6 Months Later (%)	12 Months Later (%)
All First Cuts	7.68	3.19	4.20
Slow Cycles	7.63	8.11	3.01
Fast Cycles	7.72	-0.09	4.99

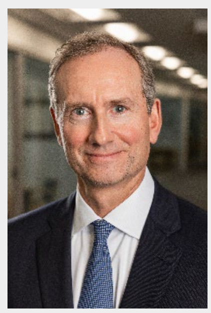
Source: Ned Davis Research.

While it is helpful to know dividend payers perform well after the first rate cut, one may question if historically it has been better to own high yielders versus dividend growers, and if it has been better to own slower or faster dividend growers (see table on previous page). The evidence would suggest that owning dividend growers is more profitable than owning high-yielding dividend stocks. Moreover, the chart above highlights how historically, owning faster dividend growers was more profitable than owning slower dividend growers.

We would note that as we enter what appears to be the start of an interest rate easing cycle, the Sterling Capital Equity Income strategy has a yield in excess of its benchmark in addition to a five-year dividend growth rate meaningfully faster than its benchmark.

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. He holds the Chartered Financial Analyst® designation and served as President of CFA Society Virginia from 2012-2013.



Important Information

Disclosures

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. Economic charts are provided for illustrative purposes only. The information provided herein is subject to market conditions and is therefore expected to fluctuate.

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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-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.

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: **Federal funds futures** are financial contracts that reflect the market's expectations for the future of the federal funds rate. The federal funds rate is the interest rate that banks charge each other for overnight loans of reserves held at the Federal Reserve. The Federal Reserve uses this rate to control the money supply and influence credit costs. The **federal funds rate** is the interest rate that banks charge each other to borrow money overnight. It's the primary tool the Federal Reserve uses to conduct monetary policy and influence the economy. (Technical definitions are sourced from Corporate Finance Institute and Investopedia.)

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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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