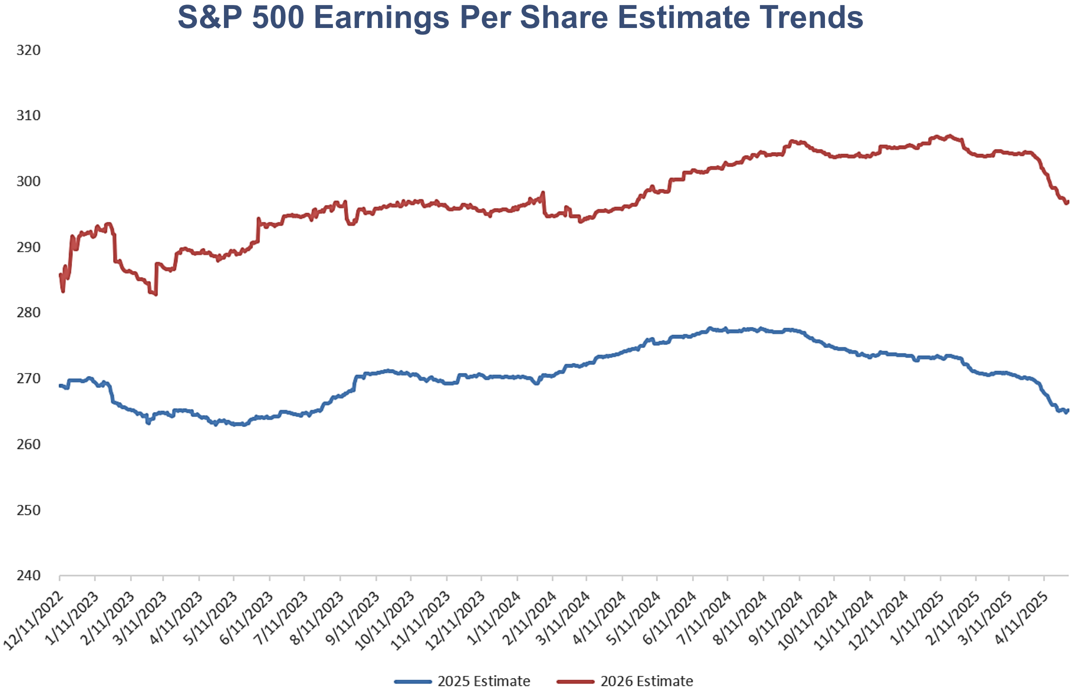
Follow the Money

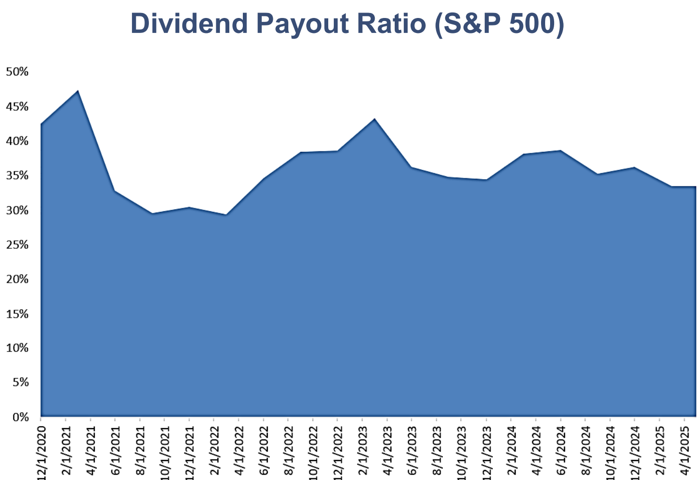
The Lead | May 2025



Source: Bloomberg L.P.

The latest U.S. gross domestic product (GDP) report saw the economy contract for the first time since 2022. The news coincided with client meetings where the same topic we discussed last month, the risk of stagflation, was raised by investors. Rising or stubbornly high inflation coupled with slowing growth has the potential to create headwinds for stocks.

We believe that this environment has the potential to benefit stocks that pay dividends rising in a consistent and sustainable manner. Those dividend payments may add to total return while higher income streams may counter the impact of inflation over time. While the output, the dividend payment, or the yield of a stock is relatively easy to ascertain, we believe the inputs that create the ability for a company to pay dividends is of critical importance, especially if the economic environment becomes challenging. In the chart above, we show corporate earnings. These earning streams are either reinvested back in the business, in share buybacks, or are paid out in dividends. Starting in the later part of 2024, aggregate Bloomberg estimated earnings for the S&P 500® Index began to moderate then decline. With declining earnings in the market, should investors begin to worry about the future dividend growth? The chart below displays the dividend payout ratio, a metric that shows what percentage of a company's net profit is returned to shareholders in the form of a dividend. The overall financial buffer to pay dividends has gradually improved over the past two years, which we see as a positive.



Source: Bloomberg L.P.

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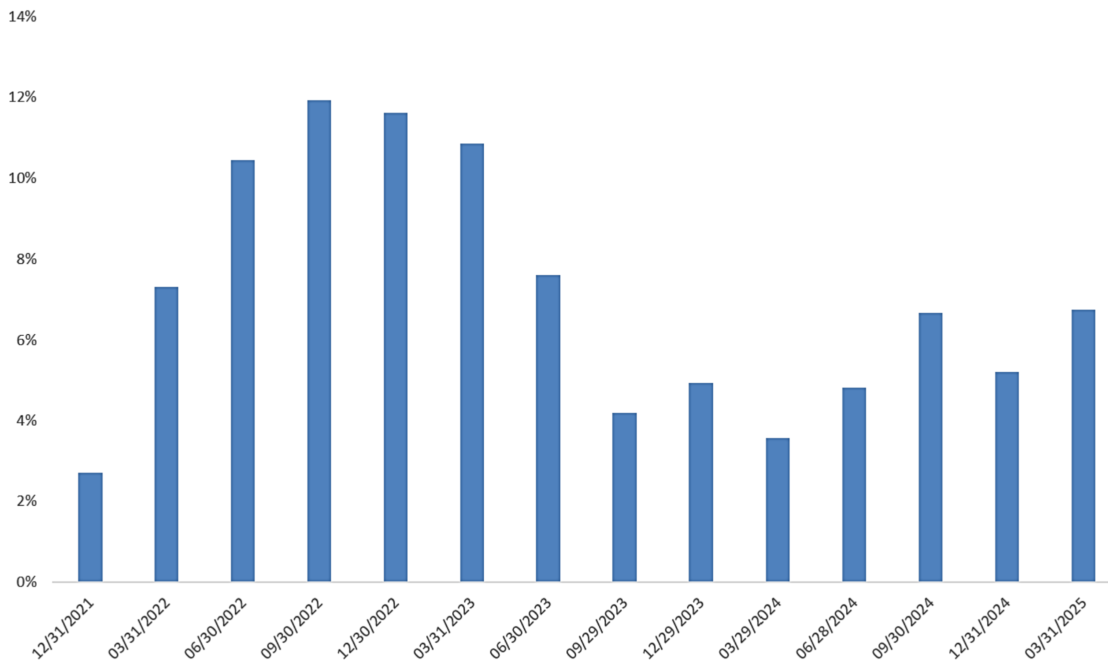
S&P 500 Year-Over-Year Dividend Growth



Source: Bloomberg L.P.

We would note, however, that the rate of the market's dividend growth has fallen almost 50%, to mid-single digits, since 2022. While we believe payout ratios offer optimism, the combination of the source of dividend payments, more tempered growth expectations, and companies signaling greater caution by moderating their commitment to return cash to shareholders via dividends is our sign to remain vigilant on the fundamental sources that generate dividend growth. Our focus on the sustainability of dividends through various economic conditions has anchored our investment process for over twenty years.

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 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.

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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: **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. **Gross domestic product (GDP)** is the total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period. As a broad measure of overall domestic production, it functions as a comprehensive scorecard of a given country's economic health. **Stagflation** is an economic condition characterized by simultaneous high inflation, high unemployment, and slow economic growth, posing a challenge for policymakers as traditional solutions can worsen the situation. (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.