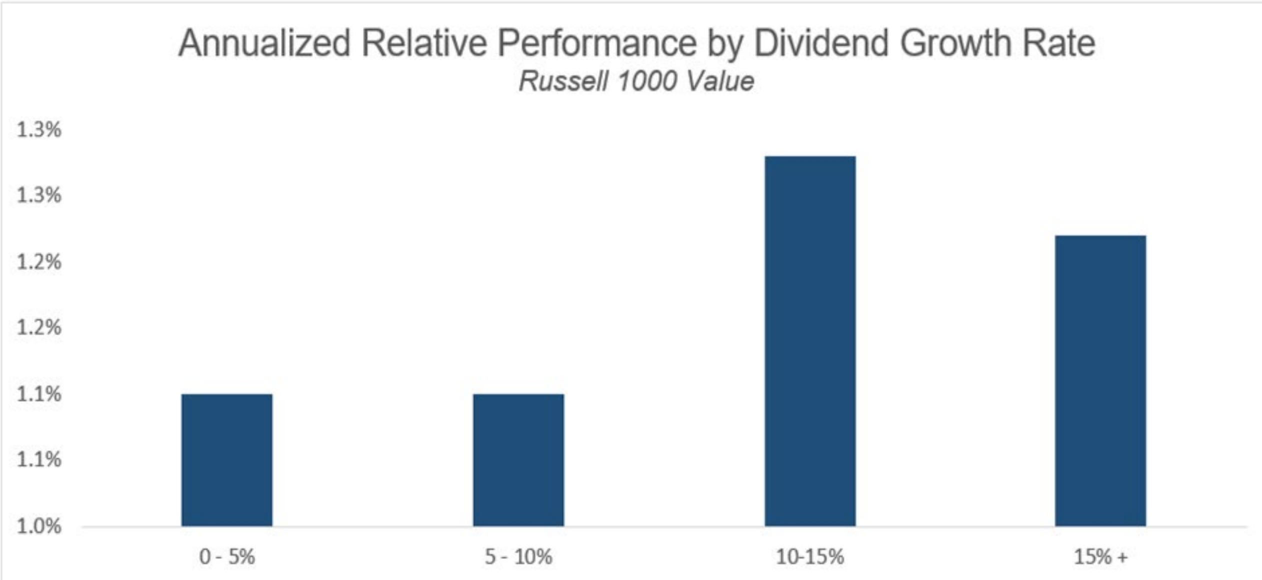
Maximizing Dividend Growth



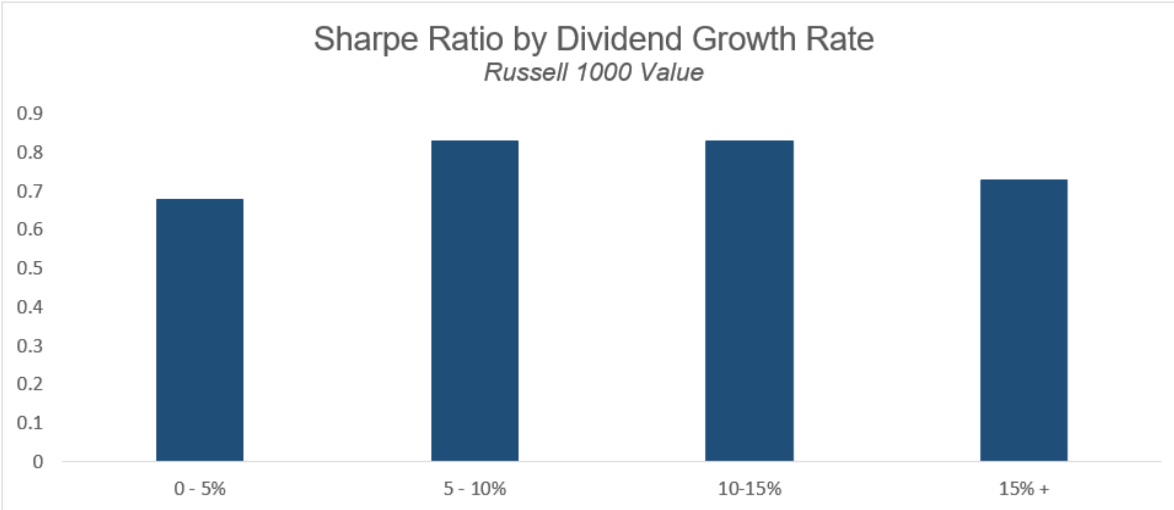
As of 06.30.2011-06.30.2021. Source: Bloomberg.

In client meetings this past month, we highlighted the benefits of stocks that provide dividend growth. This May, we augmented those discussions by noting how dividend growers outperformed the S&P 500® Index, flat dividend payers, and non-dividend paying stocks. In the chart to the right, we provide additional data supporting the performance of dividend payers over a long period of time.

While the benefits of dividend growth appear straightforward, one less-frequently asked question is whether the rate of dividend growth can be a determinant of performance. Can a manager enhance their returns if they take into consideration not only providing clients with a pay raise every year, but also the rate of change of that pay raise? In both the chart above and the chart on the second page, we explore this question. In particular, we looked for differences in performance characteristics among stocks in the Russell 1000® Value Index with disparate dividend growth rates. Within the index, we selected stocks with dividends greater than a proxy for "the market" and rebalanced the portfolio monthly. For the chart above, we used a 2% dividend yield, the average for the S&P 500 over the ten-year time period measured.

We divided the dividend growth rates for the given period into increments of 500 basis points, including stocks with annual dividend growth over 15% into the final bucket. As seen in the chart above, while each growth rate category outperforms the index, those companies that grew their dividends at double-digit rates were able to outperform the benchmark by a greater amount over the time period.

Source: Ned Davis Research



As of 06.30.2011-06.30.2021. Source: Bloomberg.

In line with our desire to provide clients with above-average returns with below-average risk, we also wanted to assess the risk-adjusted returns of each category using a standard measure of risk-adjusted return – a Sharpe ratio. In terms of risk-adjusted returns, the middle two categories appeared to offer comparable benefits relative to the other categories.

We believe the results of this research reinforce the core tenets of our Equity Income strategy, which has employed a dividend growth investment philosophy for 20 years. In fact, the dividend growth rate for the strategy averaged 11.8% for the five year period ending 06.30.2021, according to FactSet.

In selecting portfolio holdings that are not only dividend growers, but that also exhibit performance characteristics that satisfy our risk parameters, we believe our investment process can deliver attractive, risk-adjusted returns for our clients.

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 the portfolio manager of the Global Leaders strategy and associate 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.

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.

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: **Sharpe Ratio**: commonly used to gauge the performance of an investment by adjusting for its risk. The higher the ratio, the greater the investment return relative to the amount of risk taken, and thus, the better the investment. The ratio can be used to evaluate a single stock or investment, or an entire portfolio. **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.)

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