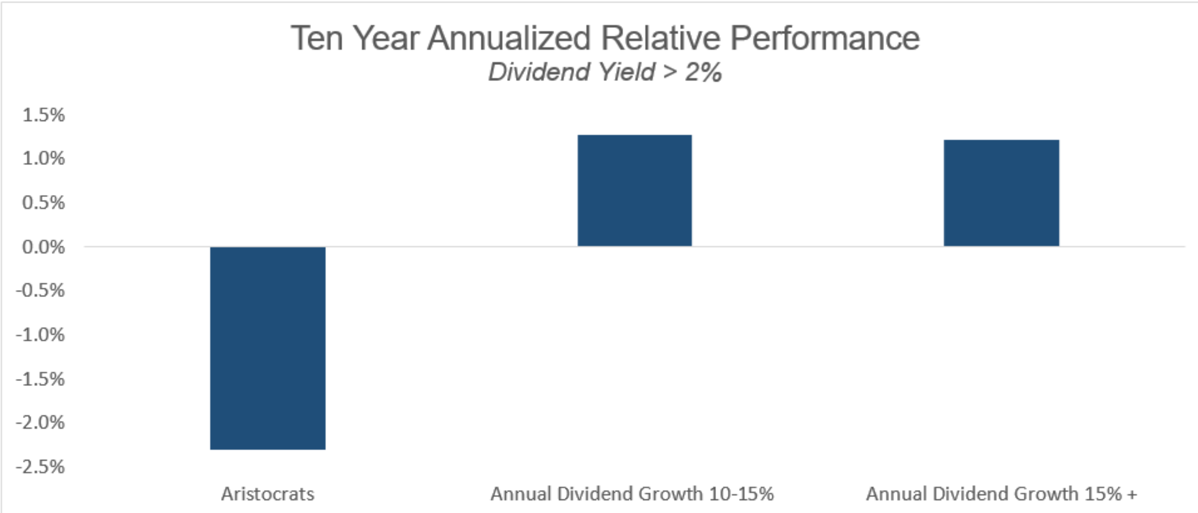
Dividend Growth Rate or Consistency? Why Not Both?

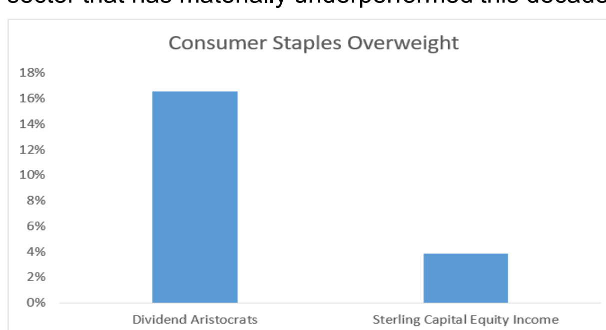


As of 06.30.2011-06.30.2021. Source: Bloomberg. Includes Dividend Aristocrats and Russell 1000® Value Index constituents for the stated time period, with stated annual dividend growth rates, benchmarked versus the S&P 500® Index.

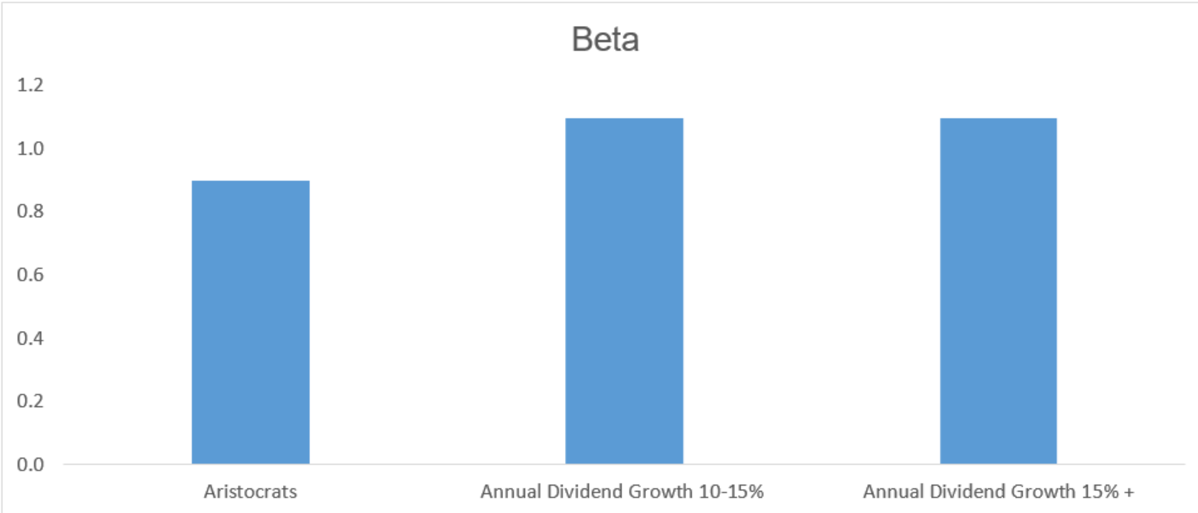
Last month, we detailed the positive aspects of not only owning companies with dividend growth and their performance characteristics over time, but also the benefits of owning stocks that provide investors with double-digit pay raises each year. One question we received from clients is whether the history of dividend growth is more important than the rate of dividend growth. Specifically, if a company demonstrated the ability to increase their dividend consistently over decades, is that more important than the rate of the annual increase?

There is a strong case to be made that it is a rare company that has both the desire and the ability to pay a rising dividend over decades, and this often indicates quality business with a sustainable competitive advantage. As of last month, there were 65 "Dividend Aristocrats," which are defined as companies that grew their dividend for at least 25 consecutive years. Over the past 20 years, this group of stocks outperformed the S&P 500, according to Bloomberg (as of 06.30.2021), but the last ten years were more of a challenge. For both Aristocrats and constituents of the Russell 1000 Value Index with double-digit annual dividend increases, we employed the same criteria we used last month to assess how stocks with dividend yields above 2% performed over the past ten years. We used the 2% yield threshold since it approximated the average dividend for the S&P 500 over the ten-year time period measured, and we were interested in stocks with "above-average yields."

We found that the biggest detractor to performance for the Aristocrats was the large overweight to consumer staples over the past ten years. As an actively-managed investment strategy, one of the benefits of our Sterling Capital Equity Income process is its ability to provide clients with sector diversification while still seeking stocks with a consistent history of providing dividend growth. The respective consumer staples overweights for each approach is noted in the chart below. At just under a 20% weight in staples, an equally-weighted portfolio of Aristocrats equates to more than 5x its Morningstar benchmark, and to a sector that has materially underperformed this decade.



Source: Proshares S&P 500 Dividend Aristocrats ETF, Factset both relative to Russell 1000 Value.



As of 06.30.2011-06.30.2021. Source: Bloomberg.

The benefits of stocks with decades of dividend growth are best seen in down markets. This dynamic is captured in the chart above, which shows the lower beta of these stocks over the past ten years. At Sterling Capital, we do not believe it is an either/or decision to own stocks with double-digit growth rates or decades of proven dividend growth. Instead, we search for both. As noted last month, the five-year historical dividend growth rate for the Equity Income strategy is in the double digits, as of 06.30.2021. However, the strategy also owns seven companies that grew their dividends annually for 25 years or more. Within Equity Income, we believe that owning strong dividend growers with proven track records while also providing proper diversification is an attractive combination to generate above-average returns with below-average risk for our clients over the long term.

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 co-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: **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. **S&P 500 Dividend Aristocrats**: also known as the Dividend Aristocrats, is an exclusive index within the Standard and Poor's 500 that was launched in 2005. It contains companies that increased their dividend payouts for over 25 consecutive years. It is a high-performance index and consists of approximately 60 large-cap stocks over a wide variety of sectors and is often considered an attractive index to invest in, as it includes many stable growth-oriented stocks. (Technical definitions are sourced from Corporate Finance Institute and Investopedia.)

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