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Are Dividends Still Relevant? (Spoiler: Yes!)

Dividend Redux (2021)[1] Suggests Reasons for Optimism in Dividend Investing

Has dividend equity investing as a style been rendered irrelevant by the post-COVID rise of equities without profits or payout, or should dividends remain an important building block of modern portfolios? This is the central question considered by Bahl & Gaynor's Bob Groenke in the recently published paper Dividend Redux (2021). While we would encourage you to delve into the detail of the paper, we summarize our primary conclusions for our friends and clients in this memo. To preview, with respect to dividends, we remain bullish.

In the depths of the 2020 COVID crisis, many a dire forecast emerged regarding the outlook for dividend equities and their distributions. In April 2020, Goldman Sachs estimated that aggregate S&P 500 dividends would decline by 23% for the year against futures markets that implied an 18% reduction.[2] Dividend equities largely avoided such a draconian scenario, with S&P 500 index dividends close to flat for the year and many exceptional companies posting double-digit dividend growth.[3] Despite this amazing reversal in economic fortunes for profitable, dividend-paying companies, the story of the year became the perplexing short-term total-return performance of a growing cohort of more speculative companies without dividends or, in many cases, profits. Witness, for example, the Goldman Sachs unprofitable technology basket, which returned +204% in 2020, or the +38% total return posted by S&P 500 non-dividend payers.[4]

Such a performance naturally begs the question of whether similar results can be extrapolated into the future. Further, how that might compare to the results of Bahl & Gaynor's chosen discipline of long-term investment in high-quality franchises that, in our estimation, can profitably and reliably compound capital and grow dividends in a way that has escaped the market's full appreciation. Dividend Redux (2021) provides extensive historical context in support of the dividend investing style, which we believe is further enhanced by our unique, active philosophy.

Four of the paper's key conclusions are summarized below:

1. The Recent Flourish by Non-Dividend Equities

Even over the recent 30-year period in which non-dividend payers have outperformed, that outperformance is concentrated in a small handful of years and not without the expense of greater risk. Non-dividend payers were behind a representative mid-dividend yield category heading into 2020 on a total return basis, while the same dividend category demonstrated meaningfully higher risk-adjusted returns. Short-lived flourishes by non-dividend equities are not without precedent in the recent data, as shown in a review of the late 1990s to early 2000s time-period.

[1] http://ssrn.com/abstract=3837937
[2] *Goldman Sachs "US Weekly Kickstart" 17 April 2020.*
[3] *Source: Bloomberg (2021).*
[4] *Source: Goldman Sachs, Bloomberg (2021).*

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2. (Nearly) A Century of Dividend Equity Returns

Long-term data spanning nearly a century and tracing multiple macroeconomic and market regimes shows significant advantages remain for dividend paying equities in compounded total and risk-adjusted returns. A representative mid-dividend-yield grouping presents significant positive "alpha" and the highest Sharpe ratio in the test, while non-dividend equities present the lowest risk-adjusted returns of any cohort in the study.

3. Dividend Factors: Quality + Low Market Risk ("Beta")

While most generic dividend returns series are well-explained by multi-factor models, from a practical standpoint, dividend equity strategies can provide an efficient implementation of multiple desirable factors in addition to a core income overlay via a single investment approach. In keeping with corporate finance theory that considers the dividend declaration as a "signal" of firm quality, "quality factors" and limited market risk-exposure ("beta") are shown to be key descriptive contributors to generic dividend equity returns.

4. The Probability of Relative Underperformance

Simulations of dividend returns show that, despite long-term risk-adjusted return advantages for the dividend equity style, periods of relative underperformance are not only possible but probable. At a 1-year horizon, the probabilities of total return "shortfall" relative to the market and non-dividend payers implied by the simulations are nearly 50%. While this shortfall probability decreases as investment horizon increases, it still exceeds 1/3rd of simulated outcomes at a 5-year investment horizon.

One of the greatest advantages earned in the discipline of investing is the ability to think long-term. We at Bahl & Gaynor sincerely believe we have the best clients in the world given your exceptional ability to share in this thinking. As always, we are thankful for your partnership and welcome your questions and comments.

You can read the entire research paper, Dividend Redux, at SSRN by clicking HERE ▶

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