DIVIDEND INVESTING: TRIED AND TRUE, FOR A REASON.

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Key Takeaways:

- Dividends can contribute significantly to portfolio growth over time through the power of compounding.
- A company's ongoing ability to pay and grow its dividend can be indicative of the company's ability to generate strong free cash flows through a myriad of market environments.
- Dividends are generally a more stable component of return than stock price performance, and can provide a steady source of income in years when market returns are negative.

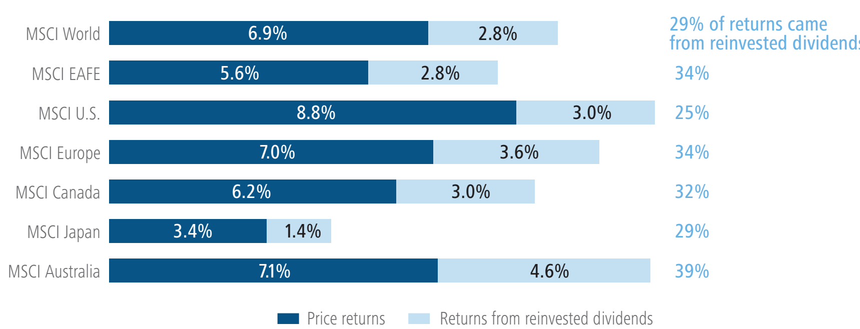
Dividends can be an important component of total return over the long term. They are often a more stable component of return than stock price performance and can help buoy a portfolio in years when market returns are negative. When a company can consistently increase its dividend over a long period of time, this is often a signal that the business is able to generate strong free cash flows through a myriad of market environments. Historically, companies that pay a dividend and grow it over time have delivered better returns with less volatility.

Below, we expand on four reasons why dividends matter to investors:

1. Dividends can be a significant component of return

Over time, dividends can comprise an important part of total returns in a portfolio. Reinvestment of dividends can result in higher portfolio growth through the power of compounding.

The chart below shows that returns from reinvested dividends can make up a substantial portion of return over time. Over the last 40 years, a significant portion of returns in major world markets came from reinvested dividends.



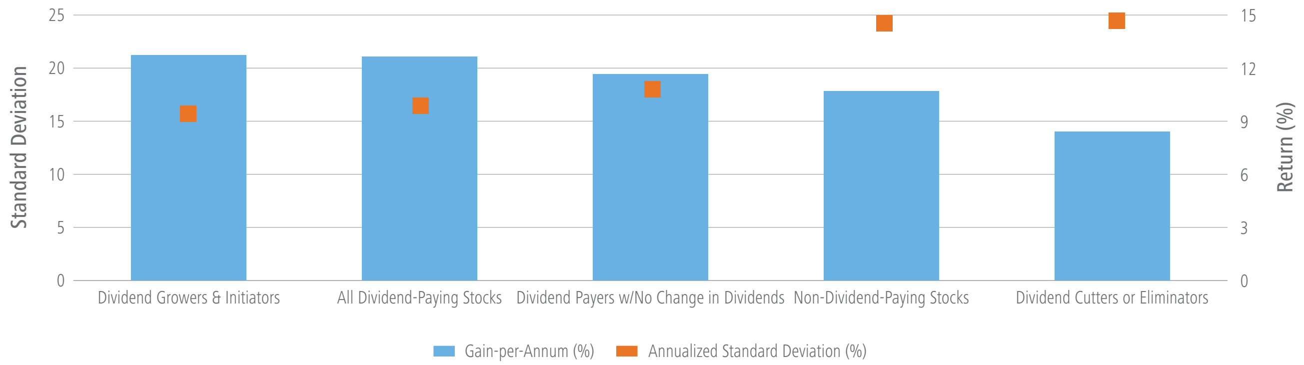
Source: Morningstar Direct. From September 1, 1979 to August 31, 2019. Returns (annualized) in local currency converted to CAD.

2. Dividend-paying companies deliver better returns with lower volatility

Dividends are not subject to the same fluctuations that stock prices are. Companies are careful to select an appropriate payout ratio that can be maintained or grown over time. When a company cuts its dividend, it is often punished by investors who sell their shares, driving the price lower. As shown by the chart below, companies that initiate, pay and grow their dividend deliver a higher return and lower risk than companies that do not pay a dividend or those that cut their dividend.

A company's ability to continue to pay a consistent dividend through a myriad of market conditions, and especially those that can grow their dividend, can be a signal of a durable business model with strong free cash flows.

Risk versus Return – S&P 500 Index Companies by Dividend Policy

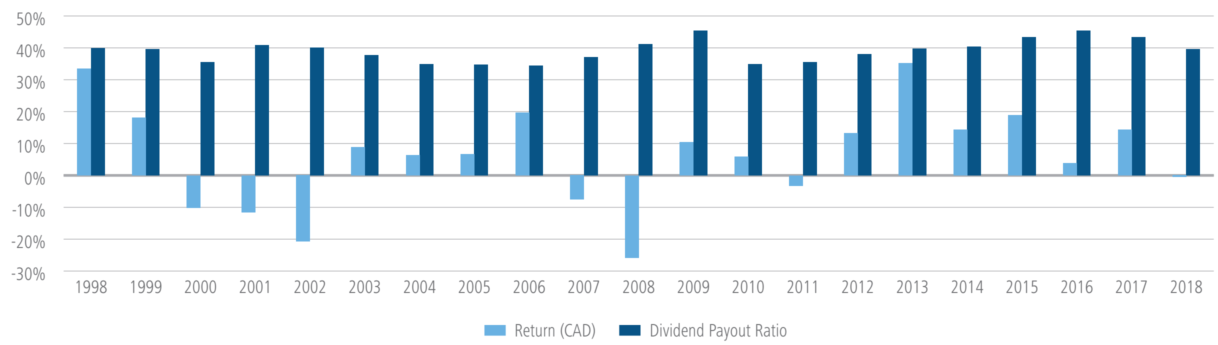


Source: Ned Davis Research, March 31, 1972 – August 31, 2019[1].

3. Dividends are a stable component of return

A company's dividend payout ratio (the percentage of earnings paid out as a dividend) is generally more stable than its share price. As shown by the chart below, the dividend payout ratio of the MSCI World Index (an aggregate of many global companies) has ranged from 34% to 45% over the last 20 years. During the same time period, the annual return of the MSCI World Index has ranged from -26% to 35% (CAD). Even during years when the market return was negative, the dividend payout ratio of the Index remained above 30%.

MSCI World Index – Annual Returns and Dividend Payout Ratio (%)

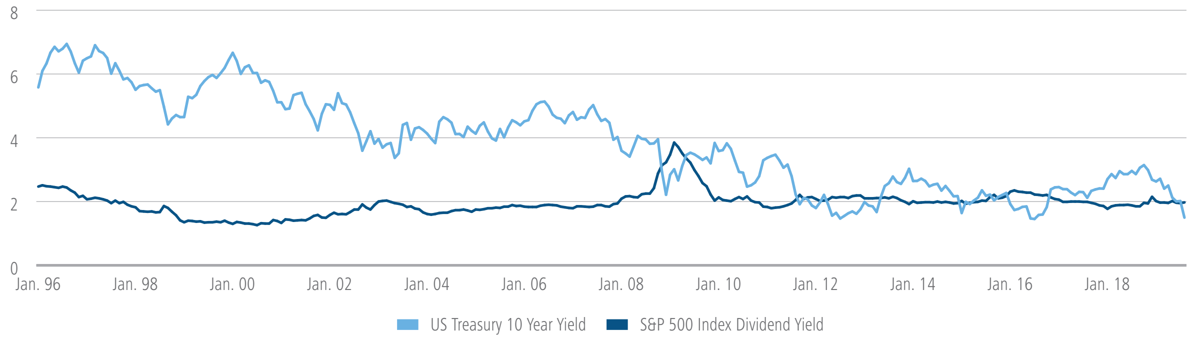


Source: FactSet, December 31, 1998 – December 31, 2018.

4. Dividends remain an attractive form of income

As central banks around the world lower interest rates, an easing of monetary policy to accommodate economic growth; yields on treasuries have fallen making them relatively less attractive as a vehicle to generate yield. This downward move in rates means they have even further to go before the historical spread between bond yields and dividend yields normalize (see charts below). As a result, dividend yields remain an attractive method of generating income.

Historical Yields on S&P 500 and US 10 Year Treasury

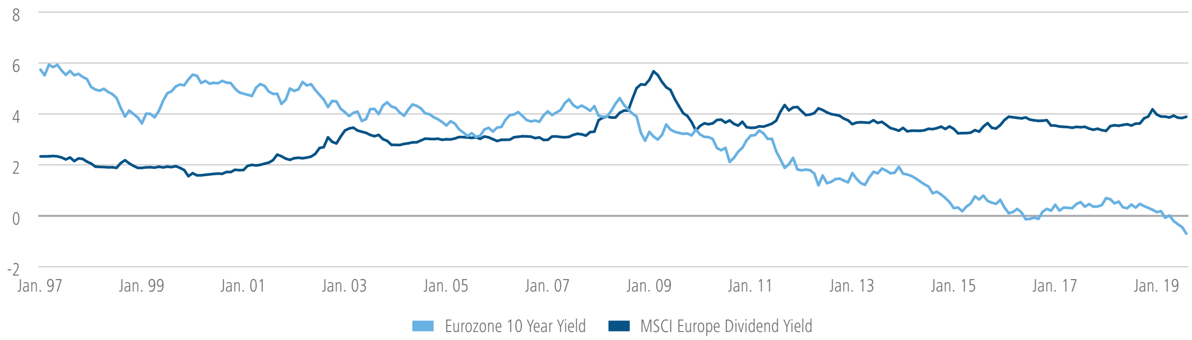


Source: Bloomberg, as of August 31, 2019.

Historical Yields on S&P/TSX Composite and Canadian 10 Year Treasury

Source: Bloomberg, as of August 31, 2019.

Historical Yields on MSCI Europe and Eurozone 10 Year Treasury



Source: Bloomberg, as of August 31, 2019.

Summary

For investors with a long-term investment horizon, reinvested dividends can contribute substantially to portfolio growth. Moreover, dividends are not subject to the same volatility as stock prices and can provide a steady source of income when market returns are negative. Dividend investing is an attractive way to generate yield, as rates would need to increase substantially before the spread between bond yields and dividend yields reaches its historical level.

Talk to your Financial Advisor about the importance of dividends in your investment strategy.

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