

AUGUST U.S. DIVIDEND UPDATE

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What’s the next catalyst for equities?

That’s the age-old question for market participants, particularly when [valuations](#) are elevated.

The current [S&P 500 forward P/E ratio](#) is 21 times, which is 20% above the median of 17.5 times of the last five years.

Here are some potential catalysts today:

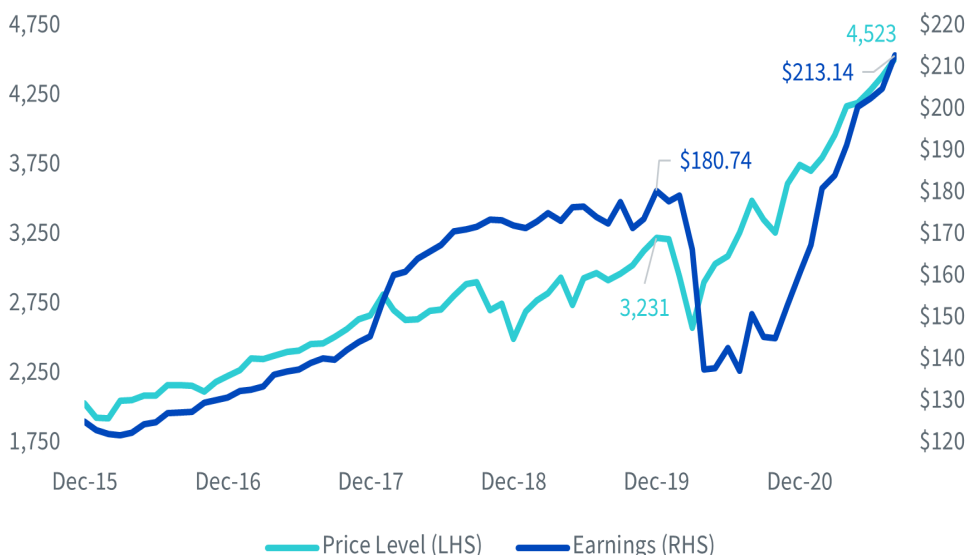
- **Fiscal stimulus** by way of a likely infrastructure package and potential green energy bill
- **Retail spending** on goods driven by a healthy U.S. consumer, thanks to generous stimulus checks and the positive wealth effect from higher stock prices and home values
- **Waning COVID-19 concerns (eventually)** that will accelerate spending on services (dining out, going to the theater) and on travel, particularly business-related

What seems increasingly likely—perhaps regardless of these catalysts—is an acceleration in payouts to shareholders in the form of dividends and share buybacks.

Earnings have rebounded to well above their pre-pandemic highs. Since the end of 2019, forward earnings on the S&P 500 are up 18%.

Market prices have fully reflected the earnings boost—[and then some](#). Price returns on the index have overshoot that earnings growth with gains of 40% over that time frame.

S&P 500 Index

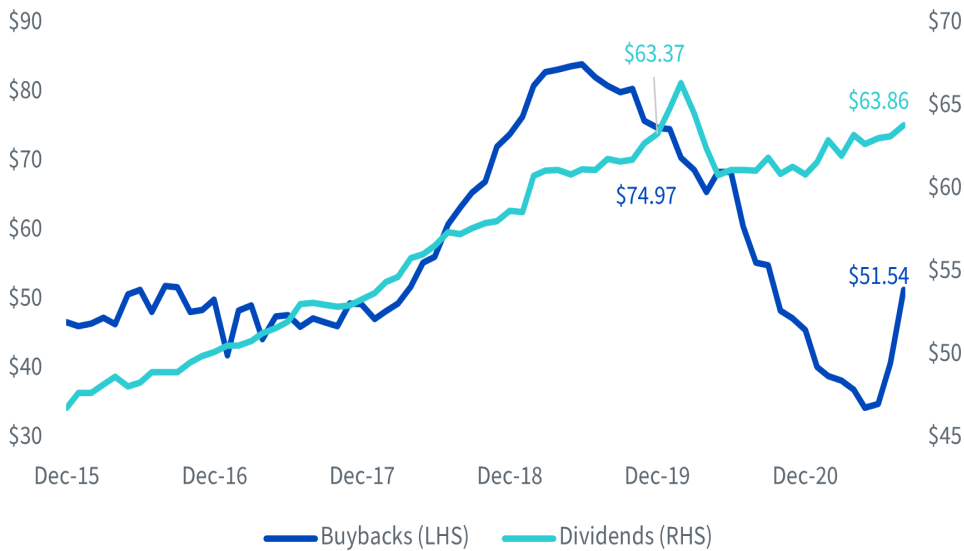


Sources: WisdomTree, FactSet, S&P, 12/31/15–8/31/21. Earnings based on forward 12-month earnings forecasts. You cannot invest directly in an index. Past performance is not indicative of future returns.

Share [buybacks](#) and [dividends](#) are on the mend this year following cuts in 2020, but there is still significant ground to be made up on payouts.

Trailing 12-month share buybacks (net of share issuance) are down by nearly a third since the end of 2019. Forward estimated dividends are roughly unchanged over the same period.

S&P 500 Index



Sources: WisdomTree, FactSet, S&P, 12/31/15–8/31/21. Buybacks are trailing 12-month. Dividends based on estimated future 12-month dividends. You cannot invest directly in an index. Past performance is not indicative of future returns.

S&P 500 companies (ex-Financials) are now sitting on \$2 trillion in cash—an increase of over 35% relative to year-end 2019.

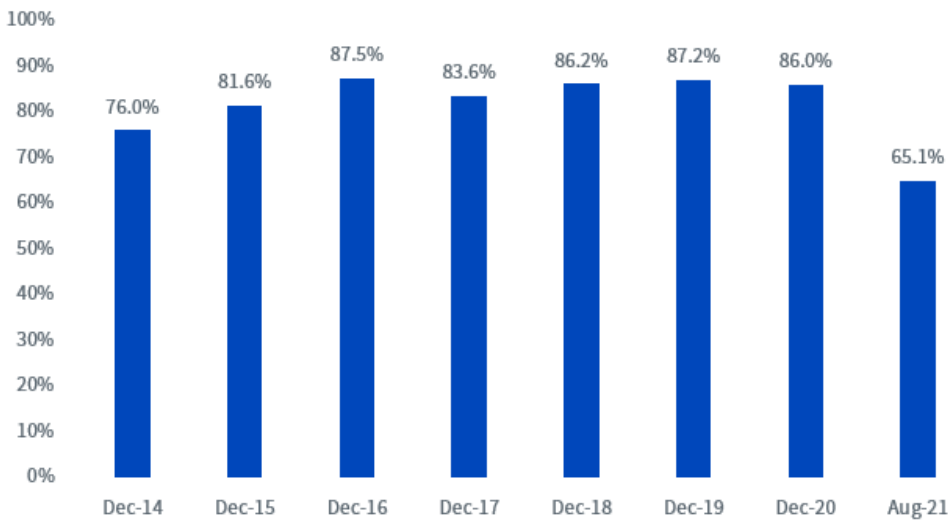
S&P 500 Cash Balance (\$ trillions)



Sources: WisdomTree, FactSet, S&P, 12/31/14–8/31/21. You cannot invest directly in an index. Past performance is not indicative of future returns.

Companies have a lot of room to make up if the latest trailing 12-month payout ratio (combining earnings and buybacks) of 65% is to revert to the mean of the recent 85% historical trend.

S&P 500 Payout Ratio



Sources: WisdomTree, FactSet, S&P, 12/31/14–8/31/21. You cannot invest directly in an index. Past performance is not indicative of future returns.

To get a better sense of how dividends relate to prices, we can separate historical S&P 500 total returns into three components:

- **Dividend reinvestment:** This rate is closely related to the starting dividend yield of the index—a higher starting yield will likely dictate a higher reinvestment of dividends
- **Dividend growth:** Growth in annual dividends per share
- **Valuation change:** This measures the price-to-dividend multiple (reciprocal of the dividend yield)—a positive change indicates prices are increasing faster than dividends

S&P 500 – Total Return Attribution				
Date	Dividend Reinvestment	Dividend Growth	Valuation Change	Total Return
2016	2.21%	4.42%	4.90%	11.96%
2017	2.02%	7.18%	11.42%	21.83%
2018	1.98%	8.95%	-13.94%	-4.38%
2019	2.02%	8.35%	18.95%	31.49%
2020	1.84%	0.41%	15.78%	18.40%
1996 – 2020	1.91%	5.95%	1.46%	9.56%

Sources: WisdomTree, FactSet, S&P, 12/31/1995–12/31/2020. You cannot invest directly in an index. Past performance is not indicative of future returns.

Using the same return decomposition framework, we can create a simplified total return forecast for the next five to seven years. Because the starting dividend yield is known (1.54% entering 2021), we can adjust assumptions for forward dividend growth and valuation change to arrive at a range of return estimates.

Using historical 6% dividend growth and a –1% return from valuation change—which seems appropriate, given elevated valuations—as base case assumptions we arrive at an estimate of about 6.5% annualized returns.

That return would be significantly below long-term S&P 500 returns of 10%–11% but would likely come out well ahead of fixed income alternatives.

$$\text{Return Estimate} = (1 + \text{Dividend Yield}) * (1 + \text{Dividend Growth}) * (1 + \text{Valuation Change}) - 1$$

S&P 500 5–7 Year Estimated Return Scenarios

	Dividend Growth Rate					
		4%	5%	6%	7%	8%
Valuation Change	-3%	2.43%	3.42%	4.40%	5.39%	6.37%
	-2%	3.49%	4.48%	5.48%	6.47%	7.47%
	-1%	4.55%	5.55%	6.56%	7.56%	8.57%
	0%	5.60%	6.62%	7.63%	8.65%	9.66%
	1%	6.66%	7.68%	8.71%	9.73%	10.76%

Source: WisdomTree. Return estimate a function of the S&P 500 dividend yield as of 12/31/20 (1.54%) and possible scenarios for dividend growth rates and valuation changes.

Conclusion

There are several catalysts with potential to drive the market higher, as well as both foreseeable and unforeseeable challenges.

If we can look through the market noise, the steady return of capital via dividends and buybacks over the next several quarters and years is likely to propel markets higher—even if valuation contraction proves a modest offset.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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You cannot invest directly in an index.

DEFINITIONS

Valuation : Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

S&P 500 Index : Market capitalization-weighted benchmark of 500 stocks selected by the Standard and Poor's Index Committee designed to represent the performance of the leading industries in the United States economy.

Forward P/E ratio : Share price divided by compilation of analyst estimates for earnings-per-share over the coming 12-month period. These are estimates that may be subject to revision or prove to be incorrect over time.

Buyback : When a company uses its own cash to purchase its own outstanding shares; may positively impact the share price.

Dividend : A portion of corporate profits paid out to shareholders.

Growth : Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.