

SEEKING EXPOSURE TO MORE SUSTAINABLE DIVIDENDS

Matt Wagner — Associate Director, Research

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In a year when most plans went off the rails, WisdomTree recently completed its regularly scheduled 2020 Domestic Equity Index reconstitutions.

As the pandemic raged on, it seemed like we'd experience a drop in [dividend payouts](#) greater than the all-time worst decline that took place during the financial crisis.

But with the full scorecard complete, remarkably, 2020 [S&P 500 Index](#) dividends were up for the year—increasing a modest 0.07% from 2019 levels.¹

Let's take a look at key changes for the [WisdomTree U.S. LargeCap Dividend Index](#) after the December [reconstitution](#).

Dividend Suspensions

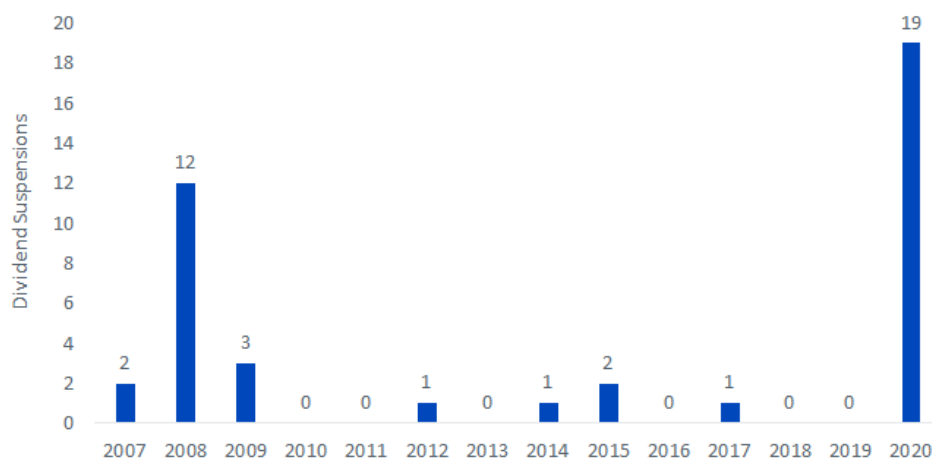
WisdomTree's dividend Indexes remove companies when dividend suspensions are announced.

During normal times, a [large-cap](#) index will have very few, if any, dividend suspensions. Boeing's dividend suspension in March 2020 was the first for an S&P 500 company since December 2017.

Nineteen companies were removed from the WisdomTree U.S. LargeCap Dividend Index for dividend suspensions in 2020—the highest of any year since its inception.

In a sign of improving economic prospects, 4 of the 19 (TJX, Weyerhaeuser, Estee Lauder and Darden Restaurants) reinstituted their dividends before the end of the year, making them eligible for inclusion at reconstitution.

WisdomTree U.S. LargeCap Dividend Index – Dividend Suspensions



Source: WisdomTree. Past performance is not indicative of future results. You cannot invest directly in an index.

Sector Changes

Unlike in 2008, when the biggest banks were the biggest dividend payers and the epicenter of the crisis, this time around the biggest dividend-paying sector was Information Technology, a sector that has directly benefited from the COVID-19 pandemic.

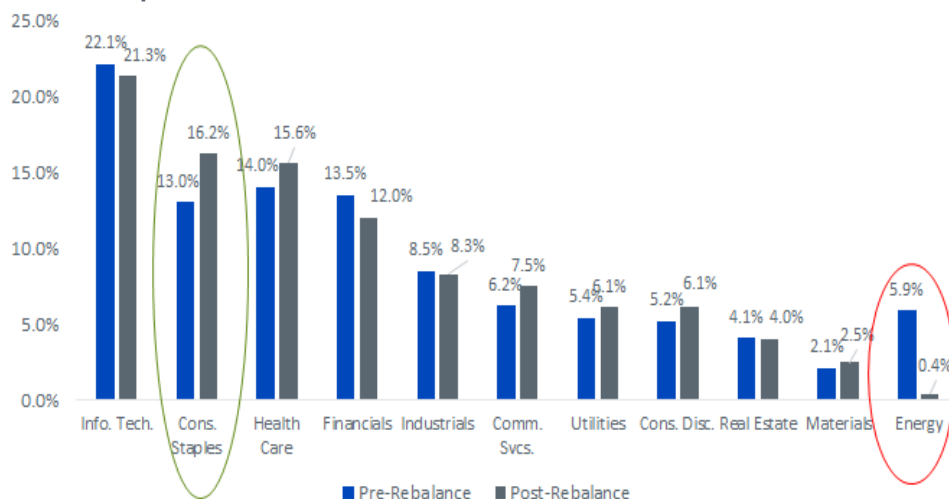
Three of the four largest dividend-paying sectors—Information Technology, Health Care and Consumer Staples—had dividend growth throughout the year. Financials, the second biggest dividend-paying sector in 2019, saw dividends reduced slightly in 2020, primarily attributable to the sector's biggest payer—Wells Fargo—trimming its dividend by

80%.

The most notable sector changes in the reconstitution were the increased weight to Consumer Staples (+3.2%) and the reduced weight to Energy (-5.5%).

The two U.S. oil majors—ExxonMobil (1.97% weight) and Chevron (1.44% weight)—were both removed from the Index by the [new composite risk screening](#) included in this year's reconstitution that aims to mitigate exposure to the riskiest dividend payers.

Sector Composition



Sources: WisdomTree, FactSet. Pre-rebalance data as of December 18, 2020, and post-rebalance data as of December 21, 2020. Weights subject to change. You cannot invest directly in an index.

Improved Quality = More Sustainable Dividends

WisdomTree's annual rebalance typically results in lower valuations and a higher dividend yield. This year's reconstitution incorporated a new enhanced risk screen that eliminated high yielders deemed to be at risk.

The two oil majors and Wells Fargo were screened out of the Index, and companies with the best risk scores were given increased weight relative to their [Dividend Stream@](#) weights.

- **Dividend yield:** Our enhanced risk screen aims to avoid companies with ultra-high dividend yields that also have poor quality and price momentum. These [high-yield](#) companies are most at risk of cutting dividends and almost certainly less likely to grow them. As a result, we see a slightly reduced dividend yield post-rebalance (2.94% vs. 2.73%)—a trade-off for potentially more sustainable dividends—but it's key to note that this yield advantage compared to the S&P 500 is in the top quintile of yield premium over the past decade.
- **Other valuations:** As a by-product of our fundamentals-based weighting and from our screen on the riskiest dividend payers, we see significantly lower [earnings multiples \(P/E ratios\)](#) from prior to the rebalance that are also significantly lower than the S&P 500 and also, notably, the [Russell 1000 Value Index](#). As a result of removing "distressed" value companies from the risk screens, our price-to-book ratio rose from prior to rebalance, but it is still below that of the S&P 500.
- **Quality:** There is a clear improvement in quality metrics for the post-rebalance Index. Aggregate [return on equity](#) improved from 12.13% to 17.33%, and [return on assets](#) increased from 2.15% to 3.14%. These quality metrics are a substantial improvement as compared to the Russell 1000 Value Index, without sacrificing on valuations as seen by lower P/E multiples.

Fundamentals Comparison

Fundamentals	Pre-Rebalance	Post-Rebalance	Russell 1000 Value	S&P 500
Price/Earnings (Trailing)	24.05	20.65	27.57	31.28
Price/Earnings (Forward)	19.19	17.44	20.23	24.64
Price/Book	3.04	3.83	2.39	4.17
Price/Sales	2.15	2.43	1.87	2.77
Dividend Yield	2.94%	2.73%	2.28%	1.57%
Shareholder Yield	4.07%	3.70%	3.19%	2.75%
Return on Equity	12.13%	17.33%	8.45%	12.84%
Return on Assets	2.15%	3.14%	1.68%	2.74%
Number of Holdings	279	300	857	505

Sources: WisdomTree, FactSet. Pre-rebalance data as of December 18, 2020, and post-rebalance data as of December 21, 2020. Russell 1000 Value and S&P 500 data as of December 21, 2020. You cannot invest directly in an index.

Bubbles Brewing and Market Rotation?

Many investors have concerns over market concentration in a handful of names that have performed extremely well over the past several years and dominate the cap-weighted S&P 500.

Some of these companies pay no dividends, making them significant active under-weights for this Index.

Index Weights – Top 5 Under-Weights

Company	WT U.S. LargeCap Dividend	S&P 500	Under-Weight
Amazon.com, Inc.	0.00%	4.39%	-4.39%
Alphabet, Inc.	0.00%	3.27%	-3.27%
Apple, Inc.	4.57%	6.70%	-2.13%
Facebook, Inc.	0.00%	2.07%	-2.07%
Tesla, Inc.	0.00%	1.69%	-1.69%

Sources: WisdomTree, FactSet, as of 12/31/20. You cannot invest directly in an index. Weights subject to change.

The significant weight that these non-payers receive, combined with overall strong performance of the market, has significantly reduced the aggregate dividend yield on the S&P 500 Index to 1.54%—its lowest level since 2004.

The yield advantage for the WisdomTree U.S. LargeCap Dividend Index is now 116 basis points²—nearly the greatest it has been in its 14-year history—all while new risk screens have made this yield advantage more sustainable, in our view.

¹Source: S&P Global, 1/6/21.

²Sources: WisdomTree, FactSet, as of 12/31/20.

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

Dividend Payout Ratio : The percentage of earnings paid to shareholders in dividends. Calculated as yearly dividends per share over earnings per share.

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.

Rebalance : An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based selection and weighting process on an annual basis.

Large-Capitalization (Large-Cap) : A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

Dividend Stream : Refers to the regular dividends per share multiplied by the number of shares outstanding.

Dividend yield : A financial ratio that shows how much a company pays out in dividends each year relative to its share price.

High Yield : Sometimes referred to as "junk bonds," these securities have a higher risk of default than investment-grade securities.

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.

Price-to-earnings (P/E) ratio : Share price divided by earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

Russell 1000 Value Index : A measure of the large-cap value segment of the U.S. equity universe, selecting from the Russell 1000 Index.

Return on Equity (ROE) : Measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.

Return on assets (ROA) : Firm profits (after accounting for all expenses) divided by the firm's total assets. Higher numbers indicate greater profits relative to the level of assets utilized to generate them.