TECH VS. UTILITIES: WHICH IS A BETTER INCOME STRATEGY?

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Ten years ago, the idea that I would be writing a research article about how technology stocks should be considered as part of an income-oriented investment strategy seemed rather implausible.

When WisdomTree's dividend-weighted Indexes launched in 2006, technology stocks, despite being the second largest sector in the S&P 500 Index by market cap at the time, at around 15% weight, represented only a small subset of dividends paid in the U.S.

Utilities, which made up the third smallest sector by weight in a market cap index, at around only 3%, contributed a greater amount of total dividends among large-cap companies than tech companies did.[1]

But the Information Technology sector has changed. The fastest growth in total dividends being paid from any sector in the last 10 years came from the technology sector, and now the single largest sector in the WisdomTree LargeCap Dividend Index—which allocates weight according to total dividends indicated to be paid—is the tech sector.

Companies like Apple, Microsoft, Cisco, Intel and IBM are among the 20 largest dividend payers in the U.S.[2]

With Growing Dividends Come Growing Dividend Yields

Technology companies have also been known for conducting stock buybacks. In finance theory, if a company has 100 shares outstanding and conducts a 3% stock buyback, so that it reduces its shares outstanding to 97, the future earnings per share and dividends per share of the company increase, without any changes in the ultimate earnings or dividends the firm is paying in aggregate. The important number is the net buybacks that account for share count issuance—let's say from stock options.

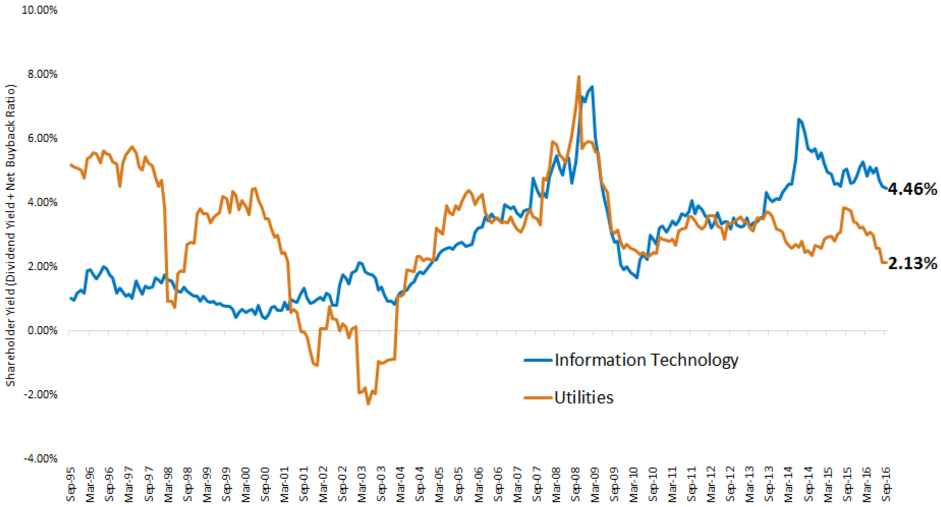
Dividends Plus Buybacks: The Edge Increasingly Goes to Technology

If we look back 20 years, in the mid- to late 1990s, there was no question which sector was a preferred income strategy: Tech companies paid few dividends and conducted minimal amounts of net stock buybacks. Utilities in 1995 had a more than 5% total shareholder yield edge over technology companies.

What is interesting is how the Utilities sector's total shareholder yield over last 20 years has displayed a few distinct trends where companies were issuing shares to fund their growth/dividends from the late 1990s to 2003, and there was actually a negative net total shareholder yield given a lot of share issuance.

Tech companies, on the other hand, have largely been growing both their dividends and their buybacks, so we have seen a generally rising total shareholder yield distribution.

Shareholder Yield: Dividend Yield Plus Net Buyback Ratio



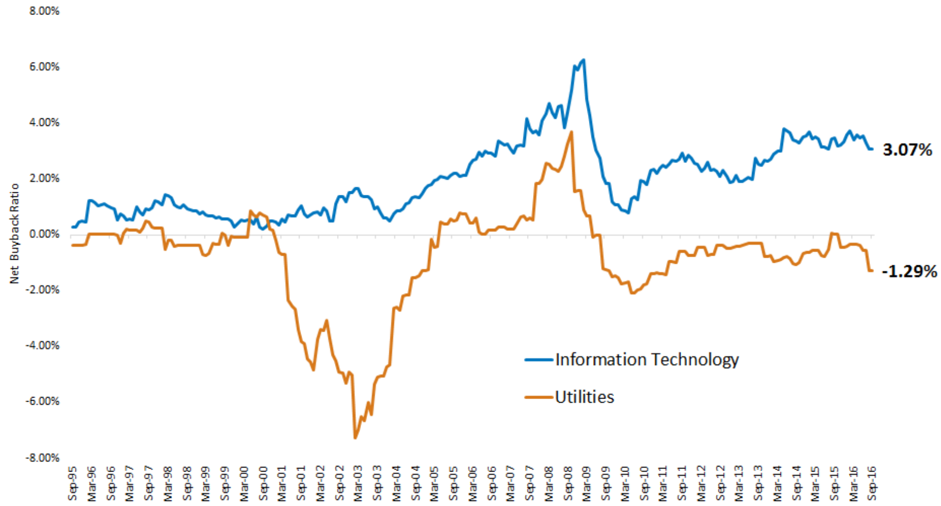
Sources: WisdomTree, MSCI, 9/30/95–9/30/16. Sectors above are for the MSCI USA Index. Past performance is not indicative of future results.
You cannot invest directly in an index.

Total Shareholder Yields Rose Together, Then Diverged

From 2004 to 2009, the total shareholder yields of the Utilities sector and tech companies were generally rising together, and they both peaked in total shareholder yields close to 8% during the financial crisis with prices declining.

But in the last three years there has been an interesting divergence: Utilities have seen their total shareholder yields decline and approach 2%, given a negative net buyback yield (meaning these Utilities are issuing shares), while technology companies have seen more robust growth in total distributions.

Net Buyback Ratio



Sources: WisdomTree, MSCI, 9/30/95–9/30/16. Sectors above are for the MSCI USA Index. Past performance is not indicative of future results.
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While Utilities have been in favor given their dividend levels and people have traditionally looked to Utilities for income, the tech sector has been growing both its dividends and its net buybacks.

In a previous blog post, we discussed why we thought the [WisdomTree U.S. Quality Dividend Growth Index] was a preferred strategy from a [valuation perspective over a high-dividend index that is concentrated in Utilities], such as the [Dow Jones U.S. Select Dividend Index].

While technology stocks are not known for their income attributes, the trends are clearly illustrating that they are growing both dividends and buybacks, and Utilities, while being one of the higher-dividend sectors, are doing share issuance that is diluting some of these dividends, making future dividend growth harder to come by. The WisdomTree U.S. Quality Dividend Growth Index has a top exposure in technology stocks, and the trends discussed here help explain why we see this as a preferred income- oriented strategy.

[1]Sources: WisdomTree, Bloomberg, as of 5/31/06.

[2]For current holdings of the WisdomTree LargeCap Dividend Index, click here.

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You cannot invest directly in an index.

DEFINITIONS

Dividend weighted : Constituent securities represented within the Index in proportion to their contribution to the dividend stream of the Index.

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.

Market capitalization-weighting : Market cap = share prices x number of shares outstanding. Firms with the highest values receive the highest weights in approaches designed to weight firms by market cap.

Dividend yields : Refers to the trailing 12-month dividend yield. Dividends over the prior 12 months are added together and divided by the current share price. Higher values indicate more dividends are being generated per unit of share price.

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

Earnings per share : Total earnings divided by the number of shares outstanding. Measured as a percentage change as of the annual Index screening date compared to the prior 12 months. Higher values indicate greater growth orientation.

Dividends per Share : The sum of declared dividends for every ordinary share issued. Dividend per share (DPS) is the total dividends paid out over an entire year (including interim dividends but not including special dividends) divided by the number of outstanding ordinary shares issued.

Stock options : Conveys to an executive the right to buy a number of shares of his firm's stock at a pre-specified price at some time in the future. Stock option holders are not eligible for any dividend distributions to shareholders.

Shareholder Yield : A data point that references the combination of dividend yield and buyback yield.

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.

Dow Jones U.S. Select Dividend Index : The index is a modified market capitalization approach and weights by dividend yield. Stocks are selected for fundamental strength relative to their peers, subject to various screens such as dividend quality and liquidity.