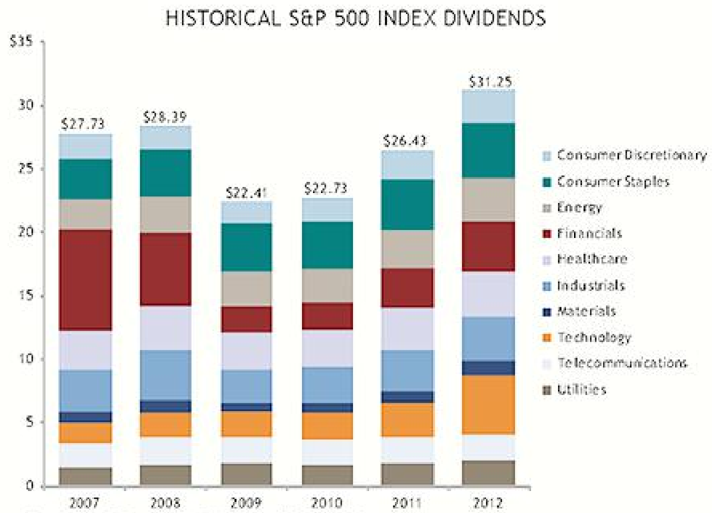
# PREPARING FOR THE FUTURE OF DIVIDEND GROWTH

**08/22/2013**

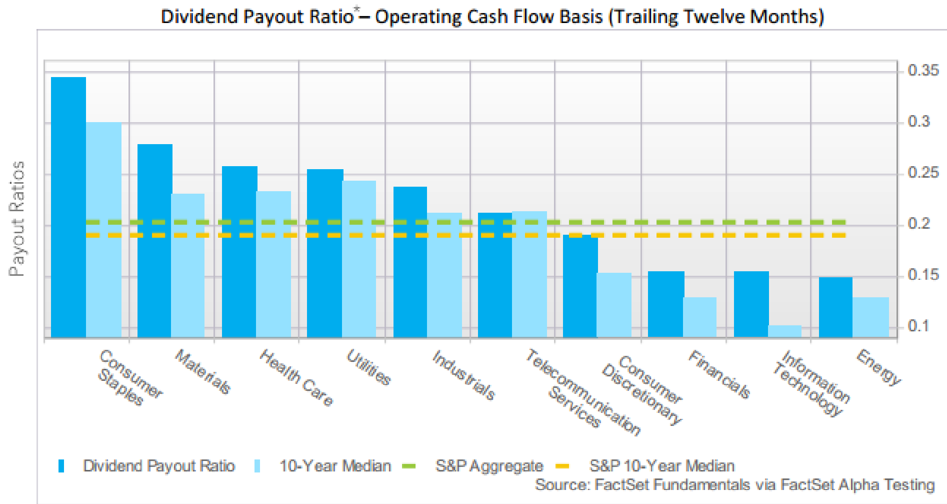
In June, I made my first appearance on CNBC to discuss dividend exchange-traded funds (ETFs). The 10-second version of what I talked about is this: While dividend increase streaks are nice, being seduced by such streaks could keep income investors away from some of the best sources of future dividend growth. People, not just investors, love streaks. Think about it: What is one of the most talked-about sports streaks of all time? Joe DiMaggio's 56-game hit streak. DiMaggio accomplished that feat in 1941. More than seven decades later, baseball fans still talk about it. Likewise, income investors love dividend increase streaks that have spanned, in some cases, more than four or five decades. Those are interesting anecdotes and vital drivers of past returns, but that does not mean sectors heavy on previous dividend raisers will continue to be the best sources of future dividend growth. Consumer Staples, Health Care and Utilities traditionally are the go-to dividend sectors, but there is an emerging "new guard" among U.S. dividend payers. One of those sectors, Financials, is experiencing a dividend renaissance, while consumer discretionary and technology names are establishing progressively larger payout footprints.[1] Financials used to pay healthy dividends, but the global credit crisis changed that. Financials, responsible for 29% of S&P 500 dividends near the market peak in 2007, led the most recent decline in S&P 500 dividends, falling from $8.07 in 2008 to just $2.03 in 2009, according to Loomis Sayles. The sector recovered to $3.93 last year[2], and the positive trajectory has continued this year, with dividend increases from many high-profile




banks.

*Source: S&P Dow Jones Indices, as of 2/28/2013.*

Past performance is not indicative of future results As the chart above shows, Technology and Financials have been the U.S. dividend growth leaders in recent years. Tech and Financials led the S&P 500 in growth of year-over-year dividends per share (49.5% and 20.2%, respectively) for the second consecutive quarter, and both sectors have logged greater than 10% growth over nine consecutive quarters, according to FactSet.[3] As the chart below indicates, Financials have a payout ratio below the 10-year monthly median. In the case of Technology, such a premium exists simply because dividends are a relatively new concept in this sector and are coming




off a low starting point. Chart data as of Q1 2013. Past performance is not indicative of future results. *Dividend Payout Ratio: The percentage of earnings paid to shareholders in dividends. Calculated as yearly dividends per share over earnings per share. Boding well for future dividend growth from the Tech sector are the following catalysts: A still-low payout ratio compared to other "dividend" sectors, strong return on equity and assets among large-cap tech stocks and the fact that Tech, as a sector, is still home to the fewest amount of dividend payers.[4] Bolstering the case for financial services and technology names as dividend payers is valuation. As in, dividend yield is more expensive than dividend growth. As of August 5, a mere 91 S&P 500 constituents had dividend yields of 3% or more, a level that is comfortably above the yield on 10-year U.S. Treasuries. Of that group, only seven technology companies and just two non-REIT financials were found. On the other hand, richly valued utilities occupied 25 spots in that group.[5] Rarely has the valuation chasm between high yielders and dividend growers been as wide as it is today.[6] That is a sign that investors are paying up for yield, but it could also mark an opportunity for investors willing to emphasize dividend growth by way of return on assets and equity over high yields. [1]Source: Richard Skaggs, "A Continuing Case For Dividends," Loomis Sayles, April 2013. [2]Source: Richard Skaggs, "A Continuing Case For Dividends," Loomis Sayles, April 2013. [3]Source: Factset Dividend Quarterly June 17, 2013 www.factset.com/websitefiles/PDFs/dividend/dividend_6.17.13. [4]Source: Factset Dividend Quarterly June 17, 2013 www.factset.com/websitefiles/PDFs/dividend/dividend_6.17.13. [5]Source: Factset Dividend Quarterly June 17, 2013 www.factset.com/websitefiles/PDFs/dividend/dividend_6.17.13. [6]Source: WisdomTree, June 17, 2013, "Dividend Growers Cheaper Than Dividend Yields?"

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## DEFINITIONS

**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.

**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.

**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.

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

**Real estate investment trust (REIT)** : Investment structure containing a basket of different exposures to real estate, be it directly in properties or in mortgages. Returns predominantly relate to changes in property values and income from rental payments.