US Quality Dividend Growth: A strong first five years against other dividend-focused indices

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We have recently surpassed five years since we launched the WisdomTree US Quality Dividend Growth Index. This approach was innovative, as until then existing indices focused on dividend growth utilized backward-looking, past dividend growth behaviour as the primary selection criterion. Both the S&P High Yield Dividend Aristocrats (20 Years of consecutive year-over-year dividend growth) and Dow Jones US Select Dividend (5 Years of non-negative dividend growth) indices are emblematic of exactly this practice.

Figure 1: WisdomTree US Quality Dividend Growth Index performance

Sources: Bloomberg, WisdomTree. The WisdomTree US Quality Dividend Growth Index began live calculation on 12 April 2013. You cannot invest directly within an Index.

Historical performance is not an indication of future performance and any investments may go down in value.

The fundamentals quilt

Figure 2 shows a “periodic table” or “quilt” for the fundamentals of the WisdomTree US Quality Dividend Growth Index, along with the other Indices.

Figure 2: US equity fundamentals “quilt”

Sources: Bloomberg, WisdomTree. Data as of 31 August 2018.

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- US equity market valuation relationships normalizing: The first four columns of the table (Dividend yield, forward P/E ratio, price to book ratio, price to sales ratio) each reference a valuation characteristic. The Dow Jones US Select Dividend Index provided the “least expensive” exposure across all of these. The WisdomTree US Quality Dividend Growth Index would be expected to have a tougher time “winning” these categories because in normal environments, the least expensive stocks rarely have the best quality characteristics. On the other hand, return on equity (ROE) and return on assets (ROA) are clearly more focused on quality. The WisdomTree US Quality Dividend Growth Index appears most strongly in these categories, whereas we saw the Dow Jones US Select Dividend Index falling off in its relative ranking across the indices shown here in Figure 2.
- Unique aspect of the MSCI USA index: In Figure 2, there are 7 total columns. The MSCI USA Index ranked the least desirable across all indices shown in 5 of them, and it was in the bottom half of the table in 6 of them. We’d remind investors to think about allocations to market capitalization-weighted benchmark exposures in the current environment in order to make sure that the characteristics they’re achieving align with their goals.

When will quality “work”?

We received a lot of questions regarding the following performance shift observed from 2017 to 2018, leading many to ask us when we think is the “right” time to invest in a strategy focused on “quality” exposure. While we may not be able to know ahead of time when exactly any index would enter its “best” environment with certainty, we can provide a framework to help in any analysis on the topic.

People looking at 2017 cumulative returns would have seen:

- WisdomTree US Quality Dividend Growth Index: 26.54%
- S&P High Yield Dividend Aristocrats Index: 15.41%
- Dow Jones US Select Dividend Index: 15.44%
- MSCI USA Index: 21.19%

Then, during the first eight months of 2018, they saw:

- WisdomTree US Quality Dividend Growth Index: 7.02%
- S&P High Yield Dividend Aristocrats Index: 5.07%
- Dow Jones US Select Dividend Index: 4.45%
- MSCI USA Index: 9.71%

2017 was a year with relatively little volatility and no noticeable market corrections. Investors were widely discussing groups of momentum stocks—like F-A-A-N-G (Facebook, Apple, Amazon, Netflix, Google)—and it was noted that these companies were driving the market higher. We were surprised that the WisdomTree US Quality Dividend Growth Index delivered such outperformance over the MSCI USA Index over this period—many of the stocks responsible for driving the market higher during this period were not dividend payers.

2018, at least thus far, is more aligned with our expectations. The Quality focus within the WisdomTree US Quality Dividend Growth Index is placing it in a better position than the other two dividend-focused indices, but it has been unable to outperform the MSCI USA Index, which holds the non-payers (like Amazon, Netflix and Google) that are still functioning to drive the market higher.

February 2018 hinted at what can occur

We saw on 5 February 20181 just how quickly volatility can return, and equity markets can drop. To be ready for these downdrafts, we believe that positioning more towards the quality factor could lead to a better chance at mitigating downside risk. Thinking about the WisdomTree US Quality Dividend Growth Index, with its quality focus, is therefore more about positioning for that next downdraft than about chasing any current momentum.

1 Refers to sharp fall in the US Stock markets and rise of the Cboe Volatility Index (VIX) recorded on 05 February 2018.

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