Capturing dividend growth requires a nimble responsiveness

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Key Takeaways

- Dividend-growth ETFs are popular among investors interested in steady cash flow and strong performance
- Most dividend-growth ETFs typically require constituents to demonstrate five, 10 or even 20 years of historical growth, but in this blog, we show that this approach has not yielded the results investors expected
- WisdomTree US Quality Dividend Growth UCITS ETF, without any historical dividend-growth requirements for constituents, has consistently outperformed other ETFs by flipping requirements to a more forward-looking view

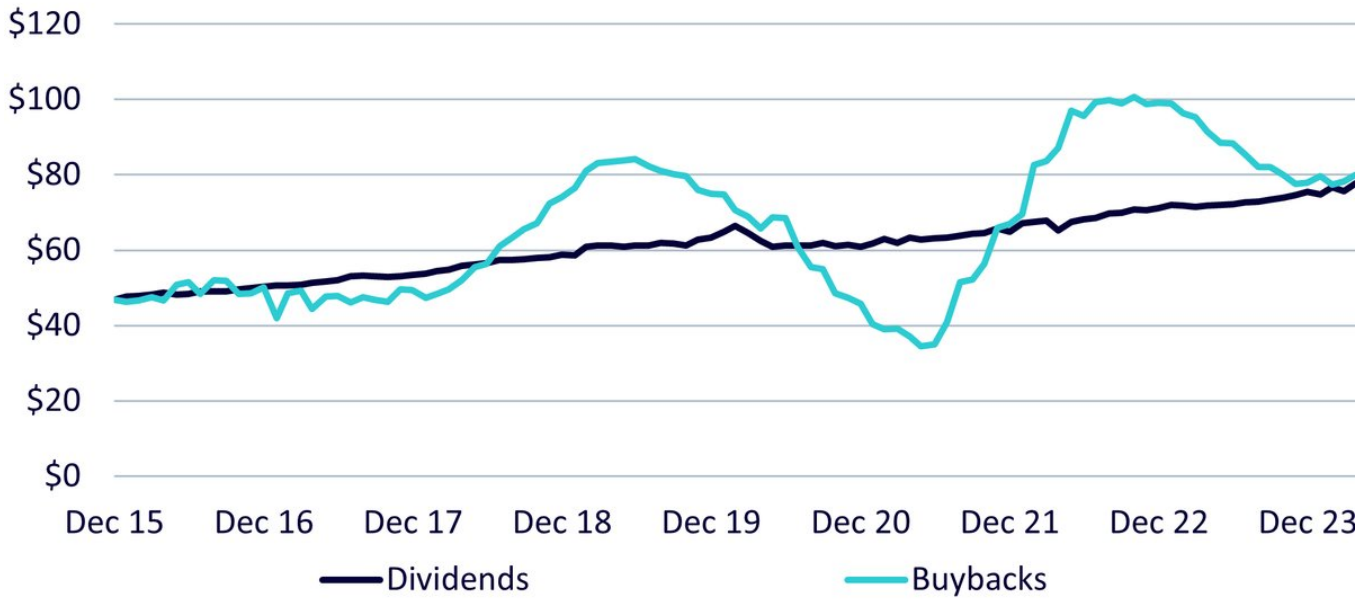
In 2024, we have seen Meta Platforms, Salesforce.com, Booking Holdings and Alphabet initiating dividend payments. Many technology companies have accumulated significant amounts of cash, with more calls to return this cash to shareholders by initiating dividends.

The psychology with which the investment world treats dividends feels more like an ongoing arrangement between the shareholders and the company. Once declared, expectations are to continue and even moderately increase over time, offering a promising outlook for investors. True, no dividend payment is ever ‘guaranteed’, but if a dividend is reduced or curtailed, it can be headline news amongst certain large companies – news these companies would prefer to avoid.

Buybacks are another way for companies to transfer cash back to shareholders, but they are less transparent and, more importantly, they are more transient and less stable in time. Boards of directors can announce buybacks that could occur over specific time frames, but they are not known about as they are happening and are only visible in hindsight where one can confirm them on the quarterly statement of cash flows.

This chart on dividends versus buybacks shows the stability versus cyclicality and volatility of buyback streams – the two are hardly comparable if one wants a predictable stream of cash flows from stocks.

Figure 1: S&P 500 index trend of dividends and buybacks on a per-share basis



Source: Source: WisdomTree, FactSet, S&P. From December 2015 to April 2024. Historical charts based on trailing five-year period. **You cannot invest in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

This stability of dividend cash flow explains why 'dividend investing' is such a big category and why dividend-growth ETFs are so well-maintained. Investors love the idea of a company raising its dividend over time and of a stream of income that has the potential to grow over time.

Here are three of the largest such, dividend growth ETFs in the ecosystem:

- WisdomTree US Quality Dividend Growth UCITS ETF (DGRW): The ETF is designed to track, before fees and expenses, the total return performance of the WisdomTree US Quality Dividend Growth UCITS Index. The index focuses on companies with strong growth and quality metrics, as defined by 1) estimated earnings growth over the next three–five years, 2) three-year average return on equity and 3) three-year average return on assets. The Index is weighted by cash dividends[1].
- SPDR S&P US Dividend Aristocrats UCITS ETF: The ETF is designed to track, before fees and expenses, the total return performance of the S&P High Yield Dividend Aristocrats Index. The Index measures the performance of companies within the S&P Composite 1500 Index universe that have followed a managed-dividends policy of consistently increasing dividends every year for at least 20 years. Weighting is focused on dividend yield[2].

- iShares Dow Jones US Select Dividend UCITS ETF: The ETF is designed to track, before fees and expenses, the total return performance of the Dow Jones US Select Dividend Index. The Index screens on numerous criteria, which include, but are not limited to 1) nonnegative historical five-year dividend-per-share growth, 2) a five-year average dividend-to-earnings-per-share ratio of less than or equal to 60% and 3) payments of dividends in each of the prior five years. Weighting is based on indicated annual dividends[3].

To summarise one critical point involving historical dividend-growth requirements for each of the indexes tracked by these ETFs:

- WisdomTree US Quality Dividend Growth UCITS ETF (DGRW) – no historical dividend-growth requirement.
- SPDR S&P US Dividend Aristocrats UCITS ETF – 20 consecutive years of historical dividend growth.
- iShares Dow Jones US Select Dividend UCITS ETF – nonnegative dividend per share growth for five years.

We underline that point because Meta Platforms initiated a regular cash dividend on 1 February 2024. WisdomTree undertook a special rebalance to immediately add this substantial dividend payer to the appropriate indexes, including the one tracked by DGRW. The other approaches will have to wait a varying number of years before Meta Platforms become eligible.

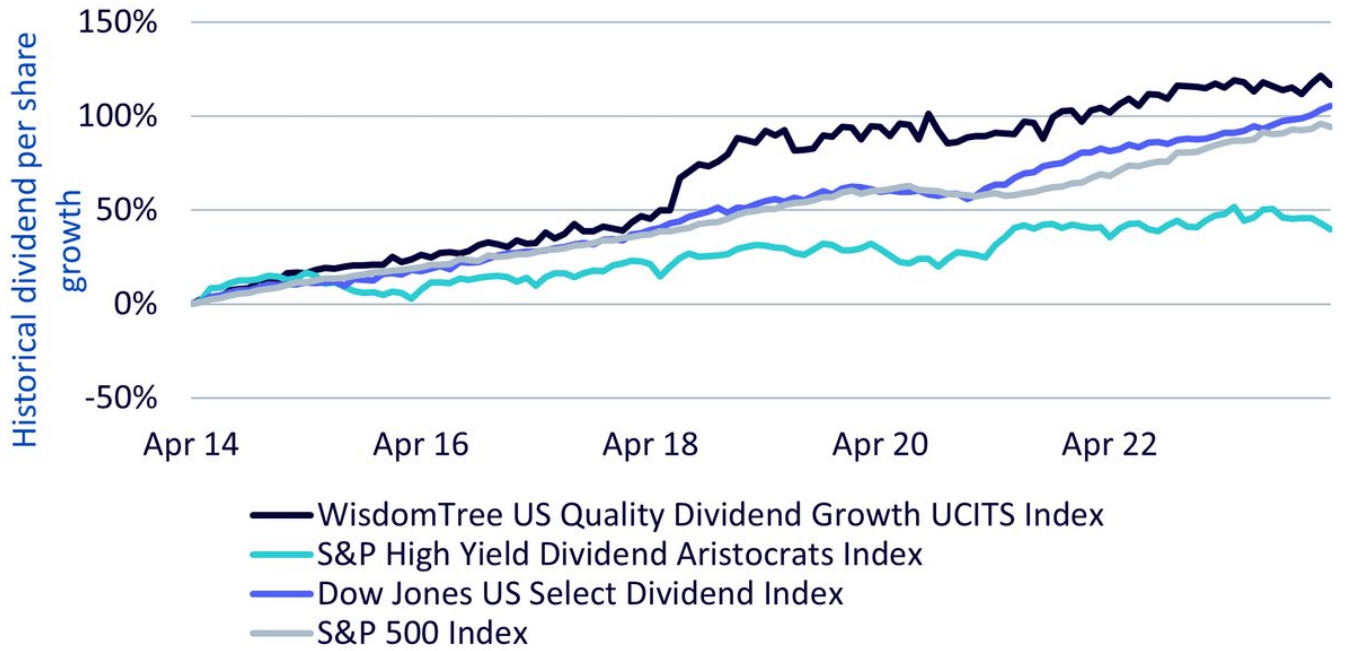
Of course, these dividend-growth requirements don't mean much in a vacuum. We believe that what investors really care about are results. If waiting 20 years to include companies that grow their dividends has been a route to strong performance and strong dividend growth in the portfolio, that's great. If not, it's a very stringent criterion for which investors aren't being compensated.

Where the rubber meets the road: Historical dividend growth and total returns

Focusing first on the explicit target of those ETFs, Figure 2 shows the historical evolution of the dividend per share of their underlying indices. We observe that the S&P grew its dividend per share by 94% over the 10-year period. In comparison, the Dow Jones index grew by a bit more, 105.6%, but the Aristocrats, despite (or because of) their very stringent constraints, grew by only half that at 40%.

WisdomTree's strategy grew its dividend the most – 116.8% over the period – despite having no explicit dividend growth constraints but by focusing instead on what makes a dividend-growing stock: its capacity to grow dividends in the future. The WisdomTree strategy focuses on companies that are growing and that are very profitable, in other words, high-quality companies. Those high-quality companies have not just the will but the capacity to grow dividends over time.

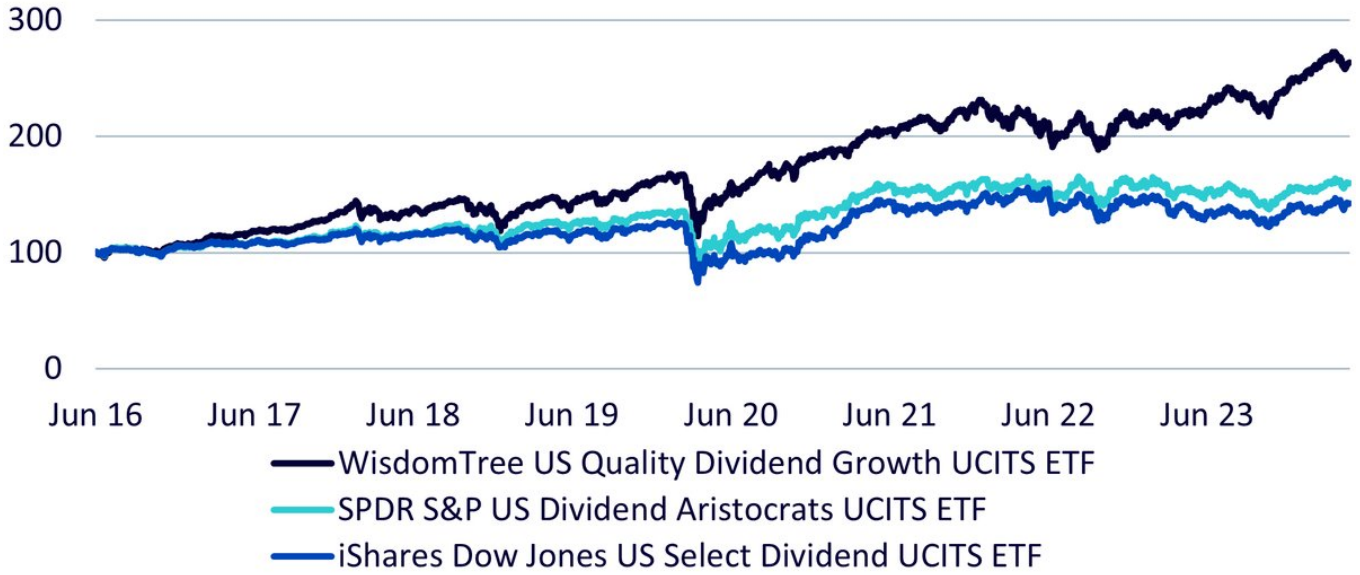
Figure 2: Historical evolution of the dividend per share of the different indices



Source: WisdomTree, Bloomberg. From 30 April 2013 to 31 March 2024. **You cannot invest in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

Figure 3 shows the performance of those different ETFs net of fees since common inception date. WisdomTree US Quality Dividend Growth exhibits the strongest returns since inception. It also shows the strongest performance over the rest of the time periods: year-to-date (YTD), one-year (1Y), or three-year (3Y).

Figure 3: Historical performance of the three ETFs



Source: WisdomTree, Bloomberg. From 7 June 2016 to 29 April 2024. YTD returns are not annualised. Other period returns are. **You cannot invest in an index. Historical performance is not an indication of future performance and any investments may go down in value.**

	YTD	1Y	3Y	Since inception
WisdomTree US Quality Dividend Growth UCITS ETF	5.4%	18.2%	9.2%	13.1%
SPDR S&P US Dividend Aristocrats UCITS ETF	2.7%	2.6%	1.2%	6.1%
iShares Dow Jones US Select Dividend UCITS ETF	2.0%	2.7%	0.5%	4.6%

Clearly, despite having a strategy without explicit dividend growth criteria, WisdomTree US Quality Dividend Growth exhibits the best dividend growth over time and the best performance over long and short time periods.

Sector exposure: The foundation of understanding dividend-oriented ETFs

Different sectors have different relationships to dividend payments. Typically, one of the starkest comparisons involves looking at Utilities versus Tech-orientated sectors such as Information Technology or some part of Consumer Discretionary, for example:

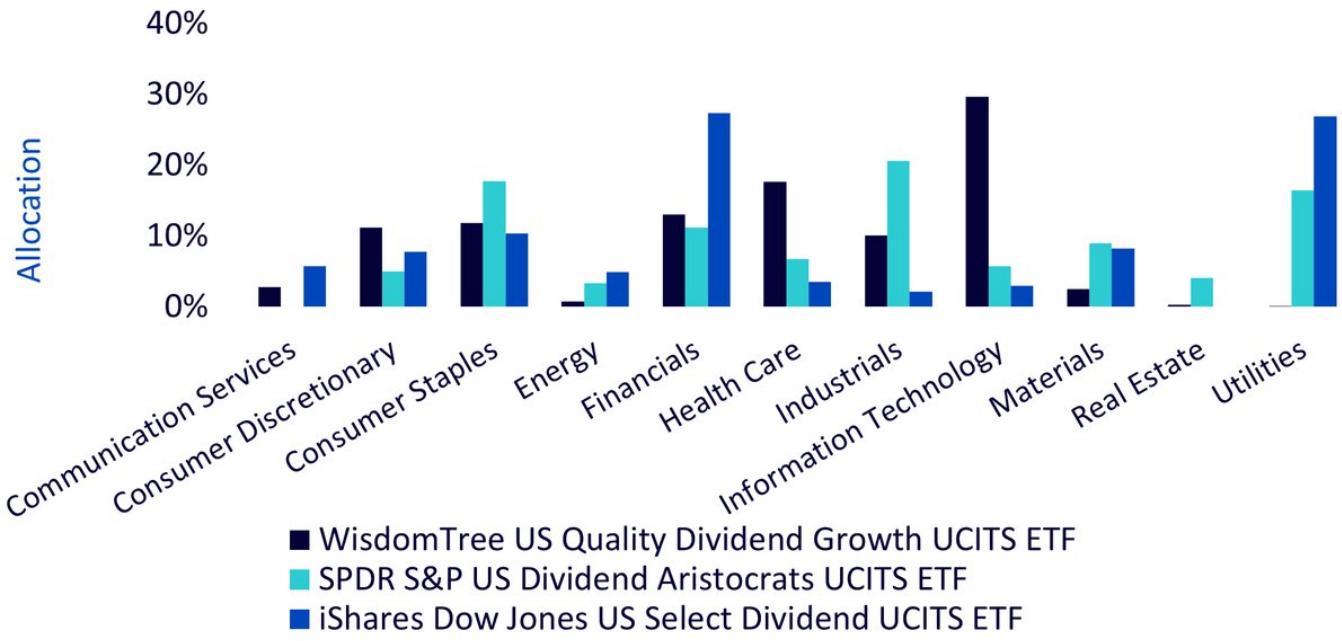
- Utilities tend to have a high current dividend yield, but utility companies do not grow their earnings very quickly and, therefore, do not grow their dividends very quickly
- Tech companies have been the engine of growth for the US equity market since the global financial crisis of 2008/9. Many of the largest companies in this sector are paying extremely large dividends, buying back lots of their own stock and still accumulating massive amounts of cash on their balance sheets. However, many of these firms may not have been paying dividends for 10 or 20 years, and we believe waiting for 10 or 20 years is an arbitrary requirement that, for example, would have disqualified Apple from 2012 (dividend initiation) to 2022, if one was looking for 10 years

When we look at figure 4:

- The Aristocrats strategy and the Dow Jones strategy emphasised the weight of Utilities ahead of the other strategies. Similarly, they tilted away from the Information Technology and Consumer Discretionary sectors
- WisdomTree placed more weight in the Information Technology sector and de-emphasised weight to the Utilities sector

We think that contrast ultimately says a lot in terms of how different strategies generate different performances.

Figure 4: A comparison of sector exposures



Source: WisdomTree, Bloomberg. 31 March 2024.

Conclusion

Dividend investing allows investors to create a steady stream of cash flow while investing in dividend-paying and dividend-growing stocks that have historically outperformed the market. Of course, the difficulty is

figuring out which companies are dividend-growing. While it makes sense intuitively to look back and search for companies that have grown their dividends historically, like with everything in investing, what has already happened is already priced in. By focusing on high-quality fundamentals and on what makes the growth of dividends possible, the WisdomTree US Quality Dividend Growth UCITS ETF has delivered very strong performance and dividend growth historically.

Sources

[1] Source: WisdomTree US Quality Dividend Growth Index, WisdomTree. https://www.wisdomtree.eu/-/media/eu-media-files/documents/1604/wisdomtree-index-methodology-217.pdf

[2] Source: S&P Dividend Aristocrats Indexes Methodology, S&P Dow Jones Indexes, updated as of January 2024

[3] Source: Dow Jones US Select Dividend Index. S&P Dow Jones Indexes.

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