One clear sign that sets good stocks apart from the rest

Published 10 July 2023

Pierre Debru
Head of Research, WisdomTree Europe.

Dividends are a fundamental source of returns for investors. Looking at an investment in the S&P 500 since 1930, 41% of the performance generated would have come from dividends1. This is almost half of the total returns. Having said that, there are many ways to invest in dividend-paying stocks: from focusing on companies with high past dividend yields, to companies with the capacity to grow their dividend in the future. At WisdomTree, we believe that high-quality, dividend-growing companies can offer investors a great long-term risk-return profile.

The historical outperformance of dividend growers

Dividends have generated a large portion of the returns for the market at large. Looking at a company level, the dividend policy is also a good indicator of performance. As illustrated in Figure 1, dividend-paying companies have outperformed non-dividend-paying companies by more than 5% annualised since the 1970s. Very interestingly, even inside dividend-paying companies, we can observe a difference between companies depending on the trajectory of their dividends. Companies that cut their dividend tend to post the worst performance. While companies that increase their dividend over time tend to do the best.

Figure 1: Performance of US stocks over the long term depending on their dividend policy

Source: Ned Davis Research. 31 Jan 1973 to December 2022. Returns based on S&P 500 stocks. Company "status" is defined based on dividend payments over the last 12 months.

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

This analysis tends to indicate that focusing on dividend-growing companies can be very rewarding for long-term investors.

The defensiveness of high-quality dividend payers

Dividend paying companies and dividend growing companies also exhibit a very interesting risk profile. To assess their defensiveness, we look at the performance of different types of equities in different market regimes, as defined by the level of volatility during the month. To do so, in Figure 2, we split all the months since 2002 into five buckets from the less volatile months in the lowest quintile to the most volatile months in the highest quintile. It is clear that high-dividend stocks and, even more so, high-quality dividend growing stocks generate, on average, much outperformance during the most volatile months (the highest quintile). In other words, in volatile months, which also tend to be bad for equities, dividend-growing stocks outperform and defend investors' portfolios. It is worth noting that, as the volatility lowers, the outperformance of high-dividend stocks tends to lower, turning to underperformance. This is not the case for high-quality dividend growing companies that, in fact, continue to outperform, or at least match, the market.

Figure 2: Average out/underperformance of strategies focused on dividend payers depending on volatility levels

Source: Bloomberg, WisdomTree. The performance data is that of indices. Data as of 30 September 2002 to 31 May 2023. Using Days data in US dollars. Calculations are in USD. The inception date for the WisdomTree Global Quality Dividend Growth Index(WisdomTree Quality) is 16 Oct 2015. You can not invest in an index. The above numbers include backtested data. Factors here are using MSCI World based Factors except for WisdomTree Quality Dividend Growth.

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

Overall, high-quality dividend growers are defensive and tend to outperform in highly uncertain, highly volatile markets, but they are also able to deliver outperformance and capture the upside in less negative markets.

Where to find dividend growing companies

Dividend growing companies can deliver long-term outperformance while protecting investment on the downside. But how can investors find those dividend growing companies? By definition, investors will know if a company is increasing its dividend only after the fact, once the dividend has been grown.

Many investment strategies look back at past dividend payments to assess a company's potential for dividend growth. While this approach is intuitive, it is not very reactive; a company would be dubbed a dividend-growing company only when it has been one for multiple years. It is also risky as it does not consider what could change going forward. However, it is possible to have a more forward-looking view, focusing not on past dividend payers but more on future dividend payers through the formula below.

Suppose a company earns $1 per share and pays a 25-cent dividend, leaving 75 cents in retained earnings. The retention ratio is 75%. Multiplying the retention ratio by the return on equity (ROE) would give you the amount of money left for future dividend payments, that is, the implied dividend growth. In other words, the implied dividend growth for a company is directly linked to the current profitability of the company. By focusing on highly profitable companies, it is possible to improve the potential for future dividend growth.

Figure 3: Higher Implied Dividend Growth for quality orientated strategies

Source: WisdomTree, FactSet. As of end of May 2023.

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

Figure 3 shows that the three Quality Dividend Growth Strategies have significantly improved Implied Dividend Growth because of their elevated ROE.

Overall, by focusing on highly profitable, earnings-growing companies, such strategies are geared towards companies with the potential to outperform over the long term, reduce risk and grow their dividend more over the next few years.

1 Source: Ned Davis Research Inc. 1 January 1930 to 31 December 2022.

Related blogs

+ Looking back at equity factors in Q1 2023 with WisdomTree

+ 4 reasons to consider quality stocks as core, long-term holdings

+ Value, Growth or neither?

+ Beating the S&P 500 is hard! Here is how our core equity ETF did it.

Related products

+ WisdomTree Global Quality Dividend Growth UCITS ETF - USD Acc (GGRA/GGRG)

+ WisdomTree Global Quality Dividend Growth UCITS ETF - USD (GGRW/GGRP)

+ WisdomTree Global Quality Dividend Growth UCITS ETF - GBP Hedged (GGRB)

+ WisdomTree Global Quality Dividend Growth UCITS ETF - EUR Hedged Acc (GGRE)

+ WisdomTree US Quality Dividend Growth UCITS ETF - USD Acc (DGRA/DGRG)

+ WisdomTree US Quality Dividend Growth UCITS ETF - USD (DGRW/DGRP)

+ WisdomTree Eurozone Quality Dividend Growth UCITS ETF - EUR Acc (EGRA/EGRG)

+ WisdomTree Eurozone Quality Dividend Growth UCITS ETF - EUR (EGRW/EGRP)

+ WisdomTree US Equity Income UCITS ETF (DHS/DHSD)

+ WisdomTree Emerging Markets Equity Income UCITS ETF (DEM/DEMD)

Important Risks Related to this Article

Important Information

Marketing communications issued in the European Economic Area (“EEA”): This document has been issued and approved by WisdomTree Ireland Limited, which is authorised and regulated by the Central Bank of Ireland.

Marketing communications issued in jurisdictions outside of the EEA: This document has been issued and approved by WisdomTree UK Limited, which is authorised and regulated by the United Kingdom Financial Conduct Authority.

WisdomTree Ireland Limited and WisdomTree UK Limited are each referred to as “WisdomTree” (as applicable). Our Conflicts of Interest Policy and Inventory are available on request.

For professional clients only. The information contained in this document is for your general information only and is neither an oer for sale nor a solicitation of an oer to buy securities or shares. This document should not be used as the basis for any investment decision. Investments may go up or down in value and you may lose some or all of the amount invested. Past performance is not necessarily a guide to future performance. Any decision to invest should be based on the information contained in the appropriate prospectus and aer seeking independent investment, tax and legal advice.

The application of regulations and tax laws can oen lead to a number of dierent interpretations. Any views or opinions expressed in this communication represent the views of WisdomTree and should not be construed as regulatory, tax or legal advice. WisdomTree makes no warranty or representation as to the accuracy of any of the views or opinions expressed in this communication. Any decision to invest should be based on the information contained in the appropriate prospectus and aer seeking independent investment, tax and legal advice.

This document is not, and under no circumstances is to be construed as, an advertisement or any other step in furtherance of a public oering of shares or securities in the United States or any province or territory thereof. Neither this document nor any copy hereof should be taken, transmitted or distributed (directly or indirectly) into the United States.

Although WisdomTree endeavours to ensure the accuracy of the content in this document, WisdomTree does not warrant or guarantee its accuracy or correctness. Where WisdomTree has expressed its own opinions related to product or market activity, these views may change. Neither WisdomTree, nor any ailiate, nor any of their respective oicers, directors, partners, or employees accepts any liability whatsoever for any direct or consequential loss arising from any use of this document or its contents.