

Are Dividend Stocks Expensive?

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Thus far in 2016, the dividend-paying portion of the equity market has outperformed the broader averages.¹ With investors navigating a sideways market in the U.S., demand for dividend-paying stocks has increased, leaving some to wonder whether dividend stocks—and the stock indexes that measure their returns—have become expensive. For example, the [S&P High Yield Dividend Aristocrats Index](#) and the NASDAQ US Dividend Achievers Select Index exhibited a [price-to-earnings ratio \(P/E\)](#) premium of 6% and 8%, respectively, relative to the [S&P 500 Index](#) as of late June. While narrow dividend indexes that focus on select stocks or that concentrate in narrow sectors of the market may exhibit P/E ratios that exceed the broader market, WisdomTree believes the best way to measure how dividend stocks are actually doing is to examine the returns and the fundamental ratios on the broadest measures of the dividend-paying part of the market. Fortunately, WisdomTree's broad dividend Indexes do exactly that in every major size segment of the U.S. market. When we use WisdomTree's dividend Indexes as proxies for dividend-paying stocks, the answer to the question of whether those stocks have become expensive is "no." Dividend stocks, in aggregate, continue to trade at discounts to the P/E multiples seen across major market capitalization-weighted indexes. For example, as of June 1, The [WisdomTree Dividend Index](#) and the [WisdomTree LargeCap Dividend Index](#) exhibited a *discount* of 4% and 7%, respectively, relative to the S&P 500 Index. The [WisdomTree SmallCap Dividend Index](#) was trading at 15% discount to the [S&P SmallCap 600 Index](#). Expanding P/E multiples can result from a kind of "momentum bias" in the market, where investors buy stocks—or stock strategies—simply because they have risen in value in the recent past. WisdomTree tries to avoid this "valuation creep" by rebalancing the dividend-weighted Indexes shown here each December in order to lower the valuation on the dividend-paying part of the market. Below, we examine recent valuations on WisdomTree's domestic dividend Indexes and how they compare to median valuations since 2006 and starting valuations in 2006—all measured compared to their comparable cap-weighted index. **P/E Ratios of WisdomTree U.S. Dividend-Weighted Indexes vs. Cap-Weighted Indexes, 2006–2016**

Index	WisdomTree Dividend Index	WisdomTree LargeCap Dividend Index	WisdomTree MidCap Dividend Index	WisdomTree SmallCap Dividend Index	Russell 3000 Index	S&P 500 Index	S&P MidCap 400 Index	S&P SmallCap 600 Index	Russell 2000 Index
June 2006	15.00	14.52	17.47	18.96	16.82	15.94	19.90	19.49	26.00
September 2011	12.59	12.10	15.98	17.37	13.58	12.65	15.97	17.70	28.29
Current	18.67	18.13	21.14	20.18	20.75	19.42	21.49	23.86	36.74
Median	15.51	15.13	19.31	21.07	17.98	16.64	20.17	22.91	36.66
P/E Expansion to Median	20.3%	19.9%	9.4%	-4.2%	15.4%	16.7%	6.6%	4.1%	0.2%
P/E Expansion Since June 2006	24.5%	24.9%	21.0%	6.5%	23.4%	21.8%	8.0%	22.5%	41.3%
P/E Expansion Since Sept 2011	48.3%	49.8%	32.3%	16.2%	52.8%	53.4%	34.6%	34.9%	29.9%

Sources: WisdomTree, Bloomberg, as of 5/31/16. You cannot invest directly in an index.

Index performance does not represent actual fund or portfolio performance. A fund or portfolio may differ significantly from the securities included in the index. Index performance assumes reinvestment of dividends but does not reflect any management fees, transaction costs or other expenses that would be incurred by a portfolio or fund, or brokerage commissions on transactions in fund shares. Such fees, expenses and commissions could reduce returns.

For definitions of indexes in the chart, visit our [glossary](#). In each and every instance, the WisdomTree Index had both a lower average P/E ratio and a lower median P/E ratio compared to its cap-weighted peer. This was also true as of the most recent quarter: Each and every WisdomTree Index exhibited a lower P/E ratio than its cap-weighted counterpart. When we compare the premium (or discount) of each WisdomTree Index to its own history, we find the following:

- Both the WisdomTree Dividend Index and the WisdomTree LargeCap Dividend Index traded at roughly a 20% premium to their 10-year median P/E, a small premium above the 17% premium the S&P 500 was trading at relative to its own 10-year history. As of May 31, 2016, the Russell 3000 Index traded at a 15% premium to its 10-year median P/E.
- The [WisdomTree Midcap Dividend Index](#) traded at just a 9% premium to its 10-year median P/E, slightly higher than the 7% premium exhibited by the [S&P MidCap 400 Index](#).
- The WisdomTree SmallCap Dividend Index, based on its most recent quarter-end P/E, was the only one of the four WisdomTree Indexes to be trading at a discount to its 10-year median P/E. Note that we show both the Russell 2000 Index and the S&P SmallCap 600 Index due to quite large median P/E ratios for the Russell 2000 Index, which typically has about 20% exposure to unprofitable companies, which raises its P/E ratio. Based on this data, we think it's fair to conclude that, like the broader market, the WisdomTree Indexes benefitted from the expansion in P/E multiples from the very low levels that existed as of September 2011. However, in each and every case we measure in the table above, the comparable cap-weighted index experienced a greater percentage increase in its P/E multiple from September 2011 than did the WisdomTree dividend Index. The Russell 3000 and the S&P 500 saw multiples expand by more than 52%, while the P/E ratio on the comparable WisdomTree Dividend Index expanded by 48% and the multiple on the WisdomTree LargeCap Index expanded by 50%. While the multiple expansions for the S&P MidCap 400 and the Russell 2000 Index were smaller in percentage terms than expansions in the large and broad-market categories, the P/E ratios on both the WisdomTree MidCap Dividend and the WisdomTree SmallCap Dividend Indexes increased by a smaller percentage than their cap-weighted peers, from September 2011 lows.

Conclusion Some investors are concerned that the overall stock market in the U.S. is trading at a high multiple, particularly in the absence of aggregate earnings growth and robust business investment. While such reservations may be warranted, that is a different argument from “dividend stocks are expensive.” If we use WisdomTree's broad dividend-weighted

Indexes as the best barometers for the performance of dividend-paying stocks in each of the size segments of the U.S. market, then it's fair to conclude that dividend stocks are not currently overvalued relative to the broader averages. In fact, they continue to trade at a discount. ¹Sources: WisdomTree, Bloomberg, as of 6/20/16. The WisdomTree Dividend Index outperformed the Russell 3000 Index by more than 400 basis points year-to-date as of 6/20/16.

Important Risks Related to this Article

Dividends are not guaranteed, and a company's future ability to pay dividends may be limited. A company currently paying dividends may cease paying dividends at any time.