How Dividend Growers Can Help with Rising Rates

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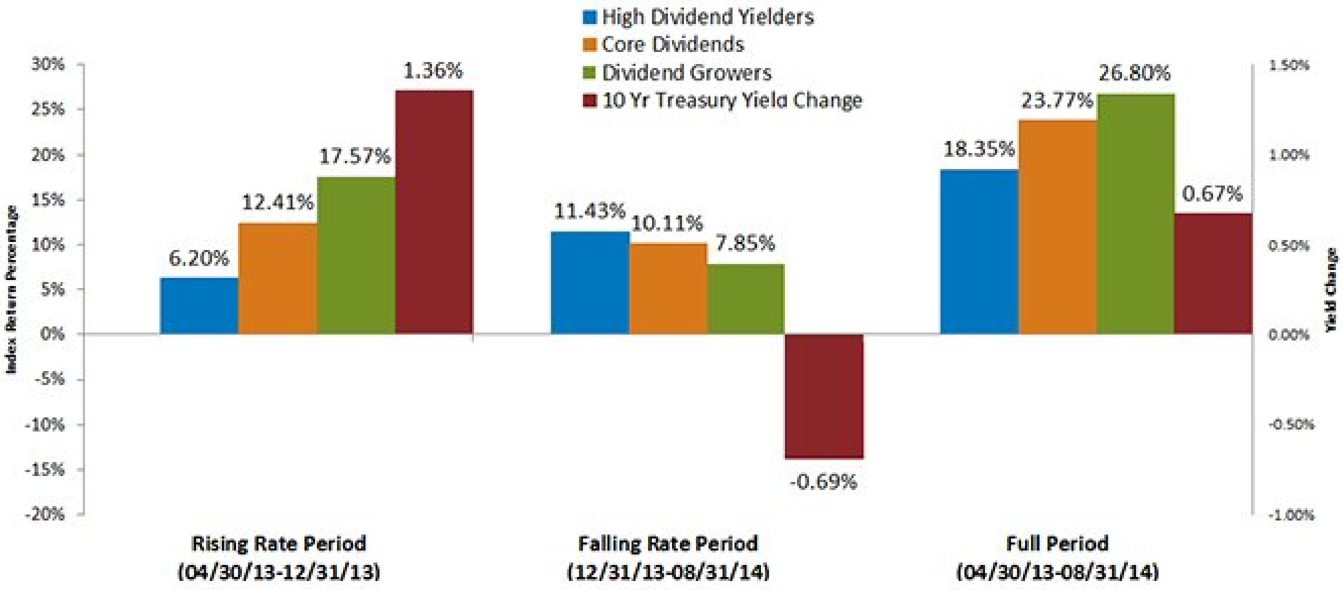
In May of last year, longer-term interest rates in the U.S. rose considerably on just a hint that the Federal Reserve (Fed) might begin scaling back its bonds purchases. Then, at the beginning of 2014, interest rates fell due to weaker U.S. economic data and deflationary concerns in Europe. These two periods caused interesting differences in performance—and as the Fed plans to end its asset purchase program in October and prepares for a potential rate hike in mid- to late 2015, we think the lessons from these recent performance divergences can be important for shaping equity allocations. So let's take a look at how the movement in Treasury yields has impacted various income-oriented investment strategies. The chart below shows the performance of various equity indexes during the rising interest rate period (4/30/13–12/31/13) and the declining interest rate period (1/1/14–8/31/14). I selected this time frame as the 10-year yield rose by 136 basis points (bps) during the rising rate period and then began a steady decline—losing 69 bps. Overall, the 10-year yield rose by 67 bps.1 For the period, I looked at the **high dividend yielders**2, **core dividends**3 and the **dividend growers**4 Indexes. **Index Performance During Rising and Falling Rate Periods**



Sources: WisdomTree, Bloomberg, 4/30/13–8/31/14. Past performance is not indicative of future results. You cannot invest directly in an index.

And here's what I discovered: • **Dividend Growers Outperformed over Periods of Rising Rates:** As interest rates began their climb in 2013, dividend growers outperformed dividend yielders and core dividends. • **High Dividend Yielders Outperformed during Falling Rate Period:** As interest rates generally declined in 2014, dividend yielders outperformed. In fact, dividend yielders and core dividends indexes outperformed the S&P 500 Index (up 9.89%). Lower-yielding dividend growers lagged in the first eight months of the year. • **Dividend Growers Outperformed over the Entire Period:** Yields rose by 67 basis points over the full period, and during that time, dividend growers outperformed both yielders and core dividends. **Consider Focusing on Dividend Growers** Given the prospects of rising interest rates in 2015, and the fact that dividend growers outperformed during these periods, we think it would be wise for investors to consider dividend-growth-focused indexes. So, what should you look for in a dividend growth index? In our opinion, screening dividend-paying equities based on earnings growth and quality factors provides substantial sector differences compared to a broadly focused index or an index that screens based on dividend yield. This is important as we expect the higher growth expectations and increased exposure to cyclical sectors could become more desirable with improving economic activity and rising rates. 1Source: Bloomberg, 4/30/13–8/31/14. 2References the WisdomTree Equity Income Index. 3References the WisdomTree LargeCap Dividend Index. 4References the WisdomTree U.S. Dividend Growth Index.

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.