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WEALTH MANAGEMENT

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THE POWER OF DIVIDENDS PAST, PRESENT, AND FUTURE

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Fads and Trends are not Part of a Sound Investment Strategy.

If everyone is talking about an investment, chances are pretty high that the price is about to drop since the masses usually buy investments after they've significantly increased in value.

With this in mind, we wonder if the recent popularity in dividend-paying stocks is just the latest trend or if there is merit to the divided argument. In this whitepaper we will look at dividends through history and examine the future for dividend investors.

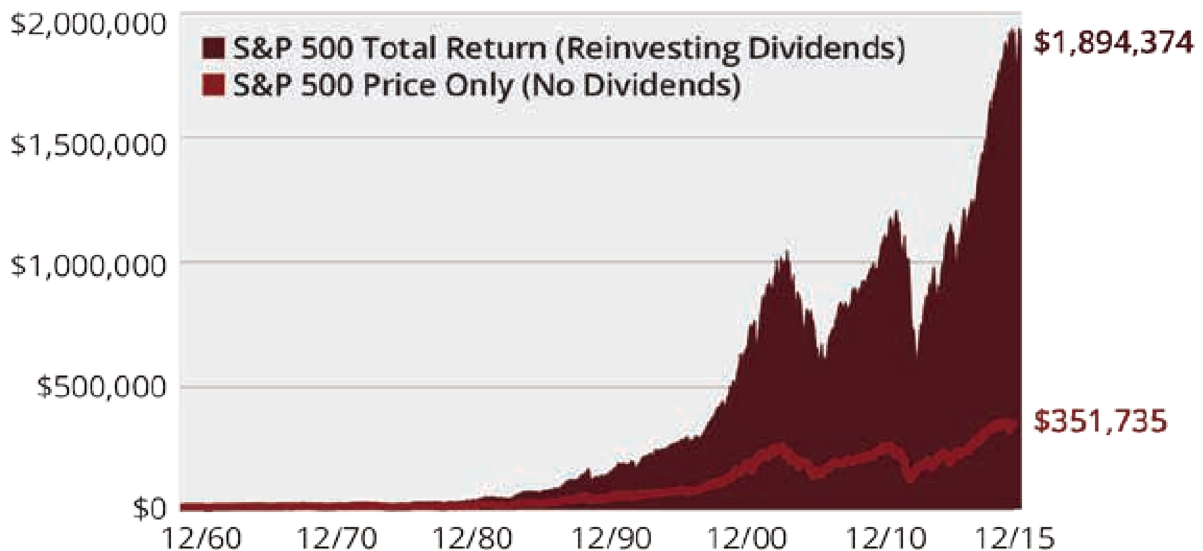
The Long-Term View

Anyone who has spent time researching investment opportunities has likely run into the following disclaimer: "past performance is no guarantee of future results." While this should not be ignored, dividend investors especially have a lot to learn from analyzing historical dividend data and a stock's dividend history. For fifty years investment returns and dividends have walked hand in hand. Since 1960, 81% of the total return of the S&P 500 Index can be attributed to reinvested dividends. See FIGURE 1.

Decade By Decade: How Dividends Impacted Returns

Looking at average stock performance over a longer time frame provides a more granular perspective. From 1930-2015, dividend income's contribution to the total return of the S&P 500 Index averaged 43%. Looking at S&P 500 Index performance on a decade-by-decade basis shows how dividends' contribution varied greatly from decade to decade.

FIGURE 1 **The Power of Dividends and Compounding**
Growth of $10,000 (12/1960–12/2015)

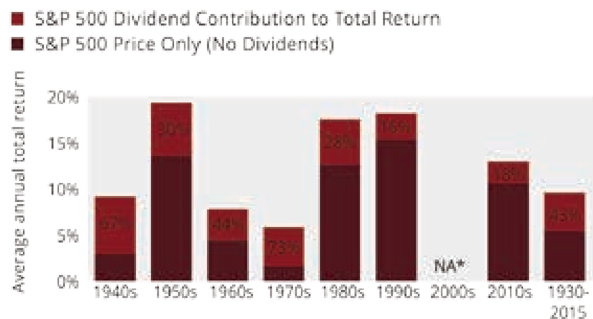


Data Source: Morningstar, 12/15.

Past performance is no guarantee of future results. The graph shown is for illustrative purposes only. Dividend-paying stocks are not guaranteed to outperform non-dividend-paying stocks in a declining, flat, or rising market. The graph is not representative of any Mutual Fund's performance, and does not take into account fees and charges associated with actual investments.

FIGURE 2

Dividends' Contribution to Total Return Varies By Decade



Data Source: Morningstar 12/15. *Total Return for the S&P 500 Index was negative for the 2000s. Dividends provided a 1.8% annualized return over the decade.

Past performance is no guarantee of future results. The graph shown is for illustrative purposes only.

In the 1940s, 60 and 70s total returns were lower than 10% and because of that dividends played a large role in terms of their contribution to total returns. In the 1950s, 1980s and 1990s however, average annual total returns were well into the double digits which reduced the role of dividends in terms of their contribution to total return.

In the 1990s companies often thought they were better able to deploy their capital by reinvesting it in their businesses rather than returning it to shareholders, so the strategy was to deemphasize dividends. Significant capital appreciation year in and year out caused investors to shift their attention away from dividends.

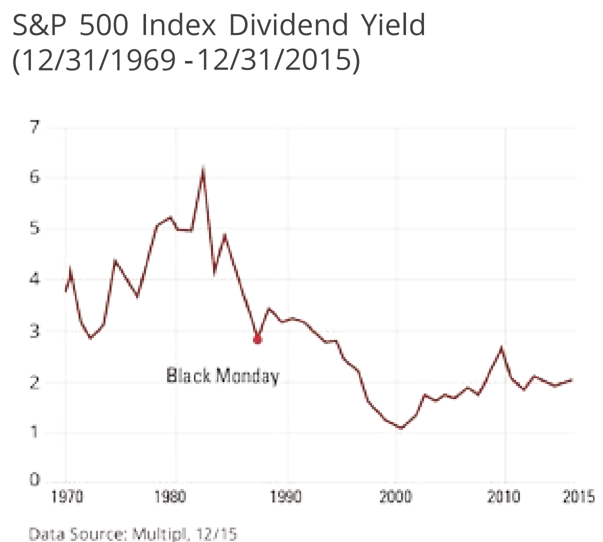
When the dot com bubble inflated and then burst by early 2000, nervous investors returned to fundamental investing practices like P/E ratios [2] and dividend yields. 2000-2009 is often referred to as the lost decade where the S&P 500 produced a negative return.

FIGURE 3 summarizes the dividend yield for the S&P 500 Index from 1970-2015. According to Multipl, the median dividend yield for the entire period was 4.33%, with yields peaking in the 1980s and bottoming in the 2000s. With a decade of no capital appreciation fresh in their minds, investors continue to place a higher premium on the more tangible and immediate returns that dividends provide.

FIGURE 3

After Bottoming in 2000, the Yield on the S&P 500 Index Has Generally Been Rising

S&P 500 Index Dividend Yield
(12/31/1969 -12/31/2015)



Past performance is no guarantee of future results. The graph shown is for illustrative purposes only. The graph is not representative of any Mutual Fund's performance, and does not take into account fees and charges associated with actual investments.

When High Beat Highest

Simply choosing investments that offer the highest yields possible is a flawed approach according to a study conducted by Wellington Management.

The study found that stocks offering the highest level of dividend payouts have not performed as well as those that pay high, but not the very highest, levels of dividends.

Why wouldn't the highest-yielding stocks have the best historical total returns? Isn't the ability to pay a generous dividend a sign of a healthy underlying business?

To begin answering these question we must first summarize the methodology and determinations of the study.

Wellington started with dividing the dividend paying stocks into quintiles with the first quintile holding the highest dividend payers and the fifth quintile holding the lowest.

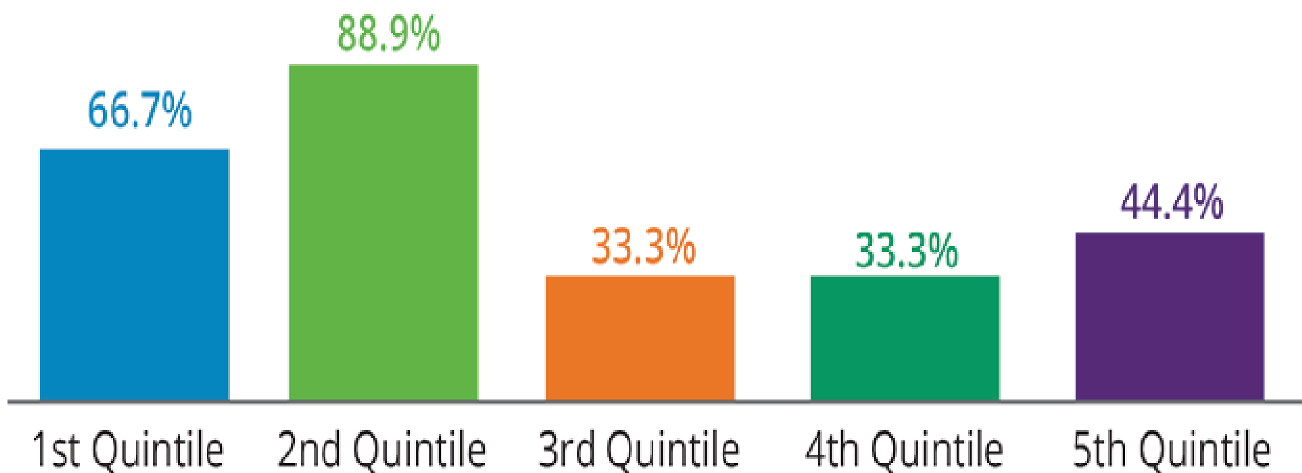
FIGURES 4 & 5 summarize the performance of the S&P 500 Index as a whole relative to each quintile over the past eight decades.

As can be seen in the figure below and in figure 5, the second quintile stocks were the best performers in all but one of the time periods between 1929-2015. First quintile stocks came in a distant second, beating the Index just 66.7% of the time. Third-, fourth-, and fifth-quintile stocks lagged behind the first and second-quintile dividend payers.

FIGURE 4

Second-Quintile Stocks Outperformed Most Often from 1929-2015

Percentage of Time Dividend Payers by Quintile Outperformed the S&P 500 Index (summary of data in FIGURE 5)



Performance data quoted represents past performance and does not guarantee future results. Source: Wellington Management.

FIGURE 5

Compound Annual Growth Rate (%) for U.S. Stocks by Dividend Yield Quintile by Decade

(1929 – 2015)

	S&P 500	1st Quintile	2nd Quintile	3rd Quintile	4th Quintile	5th Quintile
December 1929 - 1939	**-0.5%**	-1.0%	**0.8%**	-1.3%	-1.0%	2.3%
December 1939 - 1949	**9.0%**	14.0%	**13.3%**	10.4%	8.7%	7.0%
December 1949 - 1959	**19.3%**	18.5%	**20.2%**	18.3%	16.4%	19.8%
December 1959 - 1969	**7.8%**	8.7%	**8.9%**	6.6%	8.0%	9.3%
December 1969 - 1979	**5.9%**	9.7%	**10.2%**	7.0%	7.8%	3.8%
December 1979 - 1989	**17.6%**	20.2%	**19.6%**	17.1%	16.2%	14.7%
December 1989 - 1999	**18.2%**	12.4%	**15.6%**	15.1%	18.1%	18.9%
December 1999 - 2009	**-0.9%**	5.5%	**4.2%**	4.3%	1.9%	-1.7%
December 2009 - 2015	**12.8%**	14.8%	**13.7%**	12.1%	12.5%	8.4%

Data Source: Wellington Management, 12/15. US stocks are represented by the S&P 500 Index. Chart represents the compound annual growth rate (%) for US stocks by dividend yield quintile by decade from 1929-2015.

Past perfromance is no guarantee of rfuture results. The graphs shown are for illustrative purposes only. The graphs are not representative of any Mutual Fund's performance, and do not take into account fees and charges associated with actual investments.

Payout Ratio: A Critical Metric

When trying todetermine why the second quintile outperformed the first one must consider the sustainability of the first quintile's excessive payouts. So the second quintile had far more consistency than the first. The way a company's consistency of payouts can be measured is through payout ratio.

The payout ratio is calculated by dividing the yearly dividend per share by the earnings per share. A high payout ratio means that a company is using a significant percentage of its earnings to pay a dividend, which leaves them with less money to invest in future growth of the business.

Figure 6 illustrates the average dividend payout ratio since 1979 for the first two quintiles of dividend payers within the Russell 1000 Index. [3] The first-quintile stocks had an average dividend payout ratio of 67%, while the second quintile had a 46% average payout ratio.

A payout ratio in excess of 65% can be challenging to sustain. If the company experiences a drop in earnings over two or more quarters, there could be a chance that they'd have to cut their dividends. From a perception standpoint, cutting dividends

can be a kiss of death. Investors would look at the dividend cut as a sign of weakness and typically, this causes a price drop in the stock.

FIGURE 6

Average Dividend Payout Ratio

(1/31/1979–12/31/2015)

Data Source: Wellington Management, 12/15. Payout ratios are for stocks within the Russel 1000 Index.
Past perfromance is no guarantee of rfuture results. The graphs shown are for illustrative purposes only. The graphs are not representative of any Mutual Fund's performance, and do not take into account fees and charges associated with actual investments.

Do Dividend Policies Affect Stock Performance?

In an effort to learn more about the relative performance of companies according to their dividend policies, Ned Davis Research conducted a study in which they divided companies into two groups based on whether or not they paid a dividend during the previous 12 months. They named these two groups "dividend payers" and "dividend non-payers."

The "dividend payers" were then divided further into three groups based on their dividend payout behavior during the previous 12 months. Companies that kept their dividends per share at the same level were classified as "no change." Companies that raised their dividends were classified as "dividend growers and initiators." Companies that lowered or eliminated their dividends were classified as "dividend cutters or eliminators." Companies that were classified as either "dividend growers and initiators" or "dividend cutters and eliminators" remained in these same categories for the next 12 months, or until there was another dividend change.

For each of the five categories (dividend payers, dividend non-payers, dividend growers and initiators, dividend non-payers, and no change in dividend policy) a total return geometric average was calculated; monthly rebalancing was also employed.

It's important to point out that our discussion is based on historical information regarding different stocks' dividend payout rates. Such past performance can't be used to predict which stocks may initiate, increase, decrease, continue, or discontinue dividend payouts in the future.

Based on the Ned Davis study, it's clear that companies that cut their dividends suffered negative consequences. In FIGURE 7, dividend cutters and eliminators (e.g., companies that completely eliminated their dividends) were more volatile (as measured by beta[4] and

standard deviation[5]) and fared worse than companies that never paid a dividend at all (dividend non-payers).

FIGURE 7

Average Annual Returns and Volatility by Dividend Policy

1/31/72-12/31/15

	Returns	Beta	Standard Deviation
Dividend Growers & Initiators	9.81%	0.87	15.91%
Dividend Payers	8.97%	0.93	16.69%
No Change in Dividend Policy	7.20%	1.00	18.00%
Dividend Non-Payers	2.45%	1.29	24.90%
Dividend Cutters & Eliminators	-0.84%	1.22	25.11%
Equal-Weighted S&P 500 Index	7.42%	0.99	17.60%

Data Source: Ned Davis Research, 12/15.
Stocks within the S&P 500 Index.

Past performance is no guarantee of future results. The graph shown is for illustrative purposes only. The graph is not representative of any Fund's performance, and does not take into account fees and charges associated with actual investments.

Lowest Risk and Highest Returns for Dividend Growers & Initiators

Although the greatest challenges came to companies that paid dividends, but then had to cut them, it is not all bad news for dividends. Companies that either increased their dividends or initiated a payout experienced the highest returns relative to other stocks since 1972.

So the argument can certainly be made for incorporating dividend-paying stocks into an equity portfolio. What matters is what is being chosen and how sustainable the payout is and will be. Though, of course, past performance does not indicate future results, paying close attehntion to payout ratios over time can help investors make an educated decision.

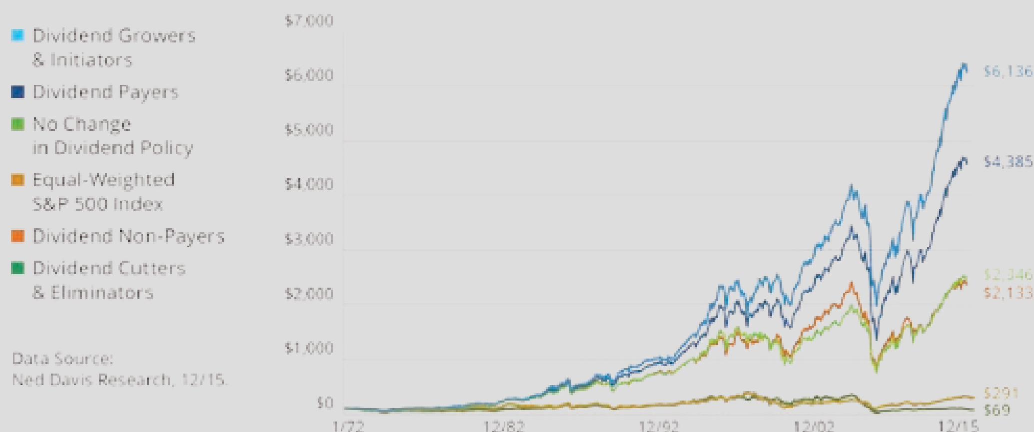
Dividend Growth: May Be a Key to Outperformance

Historically, a strong indicator for companies with strong values, sound business plans and operations and deep commitment to their shareholders has been consistent dividend growth.

The market environment also continues to favor dividends. Though the markets are beginning to see a shift in the performance of equities, there had been a period of lackluster performance, slow economic growth, and low bond yields. The U.S. Federal Reserve (Fed) may have provided support for additional dividend demand by announcing the beginning of what's expected to be a gradual rate-hike cycle in December 2015. As interest rates remain low, demand for yield should remain high.

FIGURE 8

Returns of S&P 500 Index Stocks by Dividend Policy: Growth of $100 (1/1972–12/2015)



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THE FUTURE FOR DIVIDEND INVESTORS

Trend 1: High Corporate Cash Could Bode Well for Dividends

Although the economy has been sluggish, companies have been reporting record profits which has reflected in their swollen balance sheets. In the past 15 years cash on corporate balance sheets has doubled. So what does a corporation with an excess of cash on hand do? They can expand their business, make an acquisition or they can sit tight.

While expansion and acquisition may be attractive in a more rapid growth environment, corporations often err on the side of caution in case there is another economic downturn. As we have already explored, they do not want to find themselves in a position where they would have to cut their dividends. And, in some cases, if there is enough wiggle room, companies will use this excess cash to initiate a dividend or increase their existing one.

FIGURE 9

Record Levels of Cash on Corporate Balance Sheets

(1945-2015)

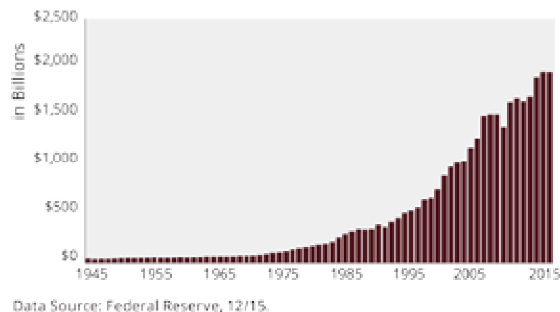
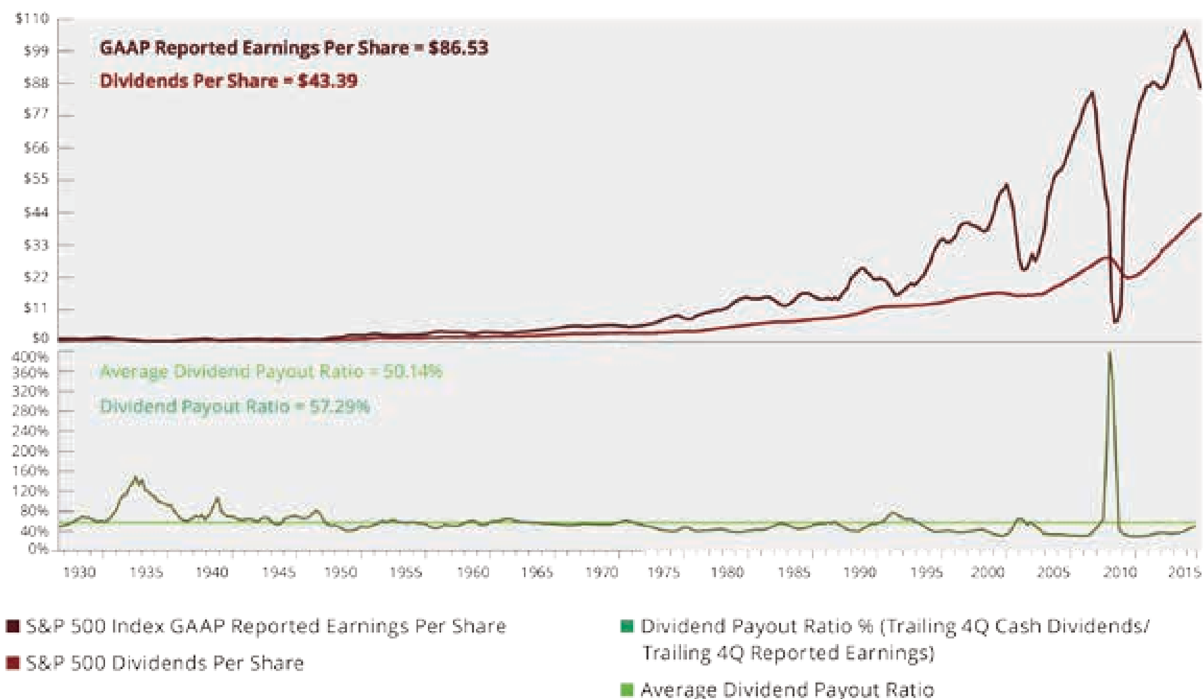


FIGURE 10 shows the confluence of two positive trends that could benefit dividend investors: high corporate profits for S&P 500 companies coupled with near record-low payout ratios. The average dividend payout ratio over the past 89 years has been 50%. As of December 31, 2015, the payout ratio stood at just 57%—leaving plenty of room for growth.

FIGURE 10
S&P 500 Index Dividend Payout Ratio Quarterly Data (log scale) 3/31/1926 - 12/31/2015



Data Source: Ned Davis Research, 3/16.

Past performance is no guarantee of future results. The graph shown is for illustrative purposes only. The graph is not representative of any Mutual Fund's performance, and does not take into account fees and charges associated with actual investments.

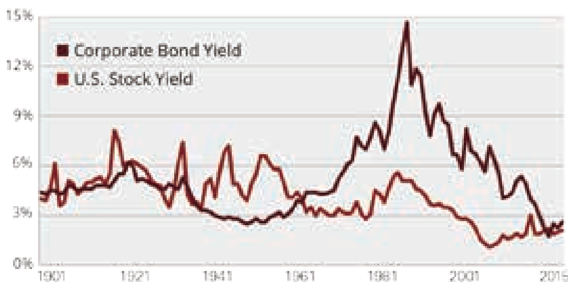
Trend 2: Low Bond Yields Could Bode Well for Dividends

With interest rates still at historic lows, dividend-paying stocks may be appealing to many investors who are seeking yield with less volatility. Those who are leaving the accumulation phase and retiring are looking for income producing investments and the low-yielding bonds, though very low risk, are not producing enough to even keep up with inflation. These institutional investors are turning to dividend stocks as a more attractive option in this climate.

FIGURE 11

Yields for U.S. Stocks Compare Favorably to Corporate Bonds

(1/1/1901-12/31/2015)



Sources: Bond Data - S&P High Grade Corporate Bond (1901-1968), Citigroup High Grade Corporate Bond (1969-1972, Barclays Govt/Corp Bond (1973-1975), Barclays US Aggregate Bond (1976 - April 30, 2013); Stock Data - Cowles Commission All Stocks (1901-1925), S&P 500 (1926-April 30, 2013).

As of December 31, 2015, 43.2% of the stocks in the S&P 500 Index have dividend yields higher than the 10-Year U.S. Treasury. While that number has fallen from record highs reached in 2012, it's still only the fourth time more than 40% of S&P 500 Index stocks have yielded more than bonds. Of those times, only one (December 1974) took place prior to 2008 (see FIGURE 12).

FIGURE 12

Percentage of S&P 500 Stocks with Dividend Yields Greater than 10-Year Treasury Yields

(1/31/1972-12/31/2015)

Trend 3: Financial Repression and Institutional Investors

The Fed held interest rates at a record-low rate of 0-0.25% until December 2015. Even though they've begun a rate-hike cycle, we've seen proof since then that it will be a slow and steady cycle, dependent on economic strength.

Monetary policy is a catalyst that helps to accelerate or decelerate economic activity, but it has other functions as well. By keeping interest rates low, the Fed helps keep interest payments on the national debt low. In other words, low interest rates benefit not only businesses and consumers who want to borrow money, but also the biggest debtor in the world: the U.S. government.

Unfortunately Low interest rates benefit debtors and punish savers. Investors who have money in Certificates of Deposit, [6] money markets, [7] and savings accounts [8] are receiving startlingly low rates. Meanwhile, low interest rates make it easier for the U.S. government to make payments on outstanding debt, and these lower payments make severe austerity measures less necessary—as long as the U.S. government doesn't continue to run up new debt while it tries to deleverage.

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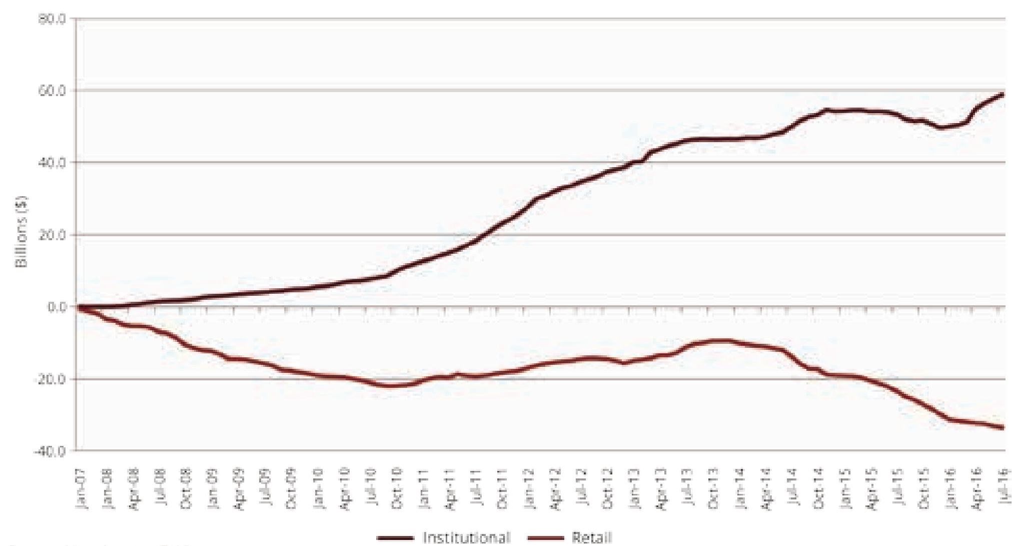
Low interest rates are especially problematic for institutional investors. How long can a pension plan with an actuarial discount rate of 6% or higher continue to accept 10-Year U.S. Treasury Bonds[9] that yield 2% to 3%? Institutional investors who have identified the trend toward financial repression have numerous options including high-yield bonds,[10] bank loans,[11] sovereign debt of foreign countries,[12] Real Estate Investment Trusts (REIT) [13] and dividend-paying stocks.[14]

In fact, since the market peaked in October 2007, institutional investors have poured nearly $60 billion into equity-income funds while individual investors have withdrawn more than $33 billion from them over the same time period. It's not uncommon for institutional investors to be ahead of the general public when it comes to investing, but how long will this striking disparity last?

FIGURE 13

Institutional Investors Have Gravitated to Equity-Income Mutual Funds While Individual Investors Have Fled Them

Cumulative Net Asset Flows 1/1/2007-7/31/16



Source: Morningstar, 7/16.

Summary

Historically, dividends have played a significant role in total return especially during periods when average equity return is less than 10% in a given decade.

Paying close attention not just to highest yield, but using the payout ratio, measurement to determine the sustainability of a payout will help investors make better decisions when selecting dividend paying stocks. Remember that stocks in the highest quintile underperformed stocks in the second quintile.

Furthermore, dividend growers and initiators have historically provided greater total return with less volatility relative to companies that either maintained or cut their dividends.

Trends that bode well for dividend-paying stocks include historically high levels of corporate cash, historically low bond yields, and baby boomers' demand for income that will last throughout retirement.

Today's historically low interest rates are leading to financial repression as a way for the U.S. government to help reduce the deficit without severe austerity measures. This has led institutional investors to invest heavily in dividend-paying stocks and strategies, which has helped bolster their performance. This trend shows no sign of abating as long as interest rates continue to remain low, and demand for these investments will only grow if retail investors follow the lead of institutional investors.

At Andersen Wealth Management we believe one can only have true financial peace of mind when one knows without a doubt they have a comprehensive financial strategy designed to provide for them during the good times, and be defensive during the bad. At Andersen Wealth Management we also understand people need an ongoing advocate to guide and protect them through life's unexpected and inevitable turns.

As investment advisor representatives, we work to help our clients avoid taking on unnecessary financial risks. Instead, we help our clients understand what their wealth represents to them: freedom, choices, stability, and a comfortable lifestyle and how they can make the choices that are best for themselves and their loved ones.

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Notes

[1] S&P 500 Index is a market capitalization-weighted price index composed of 500 widely held common stocks. Indices are unmanaged and not available for direct investment.

[2] Price/earnings "P/E" ratio is the ratio of a stock's price to its earnings per share.

[3] The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000 Index and includes approximately 1000 of the largest securities based on a combination of their market cap and current index membership.

[4] Beta is a measure of risk that indicates the price sensitivity of a security or a portfolio relative to a specified market index.

[5] Standard deviation measures the spread of the data about the mean value.

[6] A CD (certificate of deposit) is a savings certificate entitling the bearer to receive interest. A CD bears a maturity date, a specified fixed interest rate and can be issued in nearly any denomination. CDs are insured up to $250,000 per depositor by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Association (NCUA).

[7] Money market funds are not insured or guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any other government agency. Although the funds seek to preserve the value of the investment at $1.00 per share, it is possible to lose money by investing in the funds.

[8] A savings account is an account provided by a bank for individuals to save money and earn interest on the cash held in the account. Savings accounts are typically insured by the Federal Deposit Insurance Corporation (FDIC).

[9] U.S Treasury Bonds are backed by the U.S. government and are guaranteed as to the timely payment of principal and interest. This guarantee does not apply to the value of fund shares.

[10] High-yield securities, or "junk bonds," are rated below-investment-grade because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities.

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[11] Bank loans are below-investment-grade, senior secured, short-term loans made by banks to corporations. They are rated belowinvestment-grade because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities.

[12] A government bond is a bond issued by a national government denominated in the country's own currency. Bonds issued by national governments in foreign currencies are normally referred to as sovereign bonds. Timely payment of interest and principal payments on sovereign debt is dependent upon the issuing nation's future economic health and taxing power.

[13] A Real Estate Investment Trust or REIT, is a company that owns or manages income-producing real estate. REITs are dependent upon the financial condition of the underlying real estate. Risks associated with REITs include credit risk, liquidity risk, and interest-rate risk.

[14] A stock is an instrument that signifies an ownership position (called equity) in a corporation, and represents a claim on its proportional share in the corporation's assets and profits. Dividends are a distribution of a portion of a company's earnings, decided by the board of directors, to a class of its shareholders. There are no guarantees connected with the dividend payouts for dividend-paying stocks.

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The Power of Dividends | Past, Present, and Future

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