

VIDEO - Dividend Yield is Near 50-year Lows – What Corporate Behaviors are Monetizable?

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Background: Over the last 100 years, the S&P500 has averaged roughly a 10% annual return, with approximately 30% of that coming from dividends. But today, the dividend yield of the S&P500 is nearing 50-year lows at 1.24%, only lower during the Technology bubble when it troughed at 1.09%. The percentage of companies with a dividend sits at 56.5%, not meaningfully different from the last 25 years. Hence, it is clearly the largest companies by market cap. having low / no dividends that are driving this current regime. Dividend payers outperformed in Q1, and we thought we would examine this dynamic more closely.

Performance: Among stocks with high dividend yields, junk stocks perform similarly to high-quality dividend-yielding stocks over the long-term. That held true through 2024, but since then, high-yield junk stocks have materially lagged.

Beta differences are substantial: At present, high-yield junk stocks have a higher beta than high-yield stocks, even as the median stock in both cohorts have seen falling betas recently. In fact, the median high-yield non-junk stock has a beta near

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20-year lows. The result is that the difference between the beta of the non-junk vs. junk dividend yielders is just coming off of 15-year highs.

Separating junk stocks is critical: We think it is useful to take the dividend yielding universe and separate out “junk” stocks from the rest, as different signals are useful for security selection of high-yield junk stocks. For instance, companies with a higher indicated dividend yield strongly outperform those with a lower indicated dividend yield among high yielding stocks, but indicated yield has no value for stock selection among high-yield junk stocks. Price-to-forward earnings has been an effective metric among high-yield stocks, but not for high-yield-junk stocks. While price momentum has demonstrably worked for picking stocks in the US market, it doesn't work for picking winners from losers among high dividend-yielding stocks, junk or not. Companies within the high dividend space that are a lower risk to default don't subsequently outperform those that are a higher risk. Evidently that is already in the price. Long / short ideas based on these factors are on Slide 22.

We studied stock returns around the announcement of four dividend events: initiations, increases, decreases, and cancellations. For today's research, we ignore smaller but interesting events like dividend stock and one-time dividends and focus on increases, initiations, decreases, and cancellations / suspensions of dividends. The largest sample size by far over the last quarter-century is dividend increases.

Decreases: The median payout ratio of a company that increases its dividend subsequently rises from 33% to 36%. Companies that decrease their dividend have a median payout ratio of 94% pre-decrease and 74% post-decrease. Interestingly, this is larger than the median payout ratio of companies that cancel their dividend at 49%. This suggests that companies that cancel their dividend often do so due to a tail event that structurally limits their ability to pay a dividend. Those that initiate a dividend have a median payout ratio of 19% and a median indicated yield of 1.1%. The median dividend yield drops from 6.4% to 4.2% post-decrease. Companies that decrease their dividend underperform their industry group average by 14% from one year before to after the announcement as the market on average predicts financial stress. If you short a company that you think will cut their dividend, you should cover after they do, unless it was a high-quality stock, where the underperformance more frequently persists.

Increases: Dividend increases are the opposite, with moderate outperformance of 4% in the year prior, followed by in-line vs. industry average performance the year after. From 1999 to 2010, companies that increased their dividend went on to underperform their industry group following the small increase on the announcement. From 2011 to 2019, the returns have been in-line with their industry group, and since COVID-19 dividend increasers have seen some mild outperformance. This is another in many examples of shareholder returns, like buybacks as well, working better post-COVID than prior. Increasing the dividend for junk stocks and from the lowest payout ratio generate the most subsequent outperformance.

Stock ideas: Quantitatively-derived long / short ideas based on recent dividend actions are shown on Slides 17 and 18.

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