Why Dividend Payers Belong in Long-Term Portfolios

EAGLE | Asset Management

August 2023

Dividend-paying stocks have long been considered a cornerstone of investment portfolios. They can deliver consistent income and provide investors with a buffer against market volatility. Yet even with these desirable characteristics, there has been a considerable divergence between the performance of the dividend payers and non-dividend payers. While this trend has been particularly pronounced in the past few years, we do not believe it will continue. Here, we address this divergence and provide a rationale for why owning dividend-paying stocks continues to make sense for portfolios focused on income generation.

What causes divergence in performance?

Companies that consistently pay dividends are often viewed as financially healthy and well managed. For a company to maintain a regular dividend payout, it must generate sufficient profits and have a positive outlook on its future growth. Investors are naturally drawn to such companies. They perceive them to be less risky and more likely to withstand economic downturns or inflationary environments.

However, with any investment there are periods when its characteristics go in and out of demand. During market environments like we saw in 2022, when the S&P 500 Index fell by more than 18%, dividend-paying securities proved their ability to offer investors protection on the downside. Stocks in the S&P 500 that paid a dividend in 2022 declined by 11.1%, while those that didn't pay a dividend experienced a loss of 38.7%. This trend has reversed itself through the first six months of 2023, with the dividend payers returning 12.2% versus 36.7% for the nonpayers.

What lessons does history offer?

While the level of outperformance by the non-dividend payers through the first half of 2023 is notable, a look back at similar six-month periods show this year is not the first time a gap this wide has occurred.

As the chart shows, even when the short-term (over six months) difference between the performance of the dividend payers and nonpayers significantly widened over the past seven years, any period of underperformance by the dividend payers quickly reversed and usually led to a strong rebound.

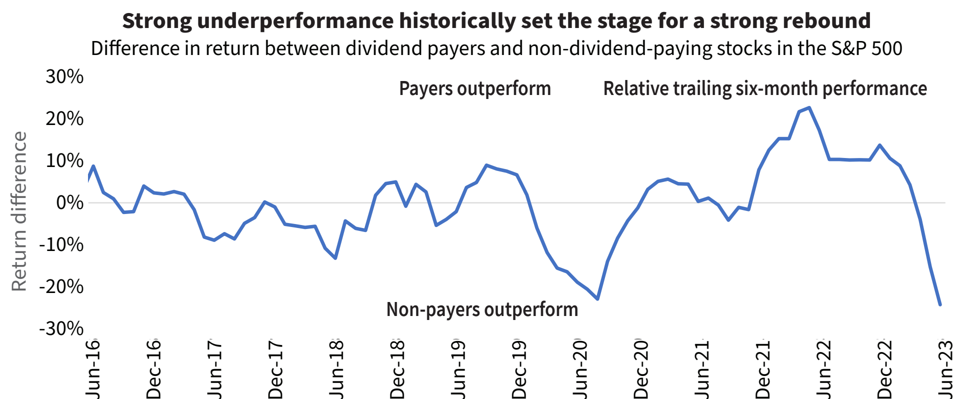
What porftolio role do dividend payers play?

With support from the evidence that history provides, we believe it is important for investors to maintain exposure to dividend-paying stocks given the attractive characteristics of these companies and their management team's commitment to focusing on longer-term returns.

As investors continue to seek stable income streams and attractive yields, dividend-paying companies are likely to remain an essential component of well-diversified investment portfolios. Their steady performance and ability, through their dividend payments, to signal their financial health make them a compelling choice for both income-focused and growth-oriented investors alike. As with any investment, however, it's crucial for investors and their financial professionals to conduct thorough research and consider each individual's financial goals and risk tolerance before making any investment decision.

Strong underperformance historically set the stage for a strong rebound

Difference in return between dividend payers and non-dividend-paying stocks in the S&P 500



Source: Bloomberg, as of 6/30/23

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About Eagle Asset Management

Eagle Asset Management provides a broad array of fundamental equity and fixed-income strategies designed to meet the long-term goals of institutional and individual investors. Eagle's multiple independent investment teams have the autonomy to pursue investment decisions guided by their individual philosophies and strategies.

Risks associated with Equity Income investing:

Equity income investing is based upon the identification of companies that possess both moderate growth rates as well as higher-than-average and consistent dividend distributions. There are risks associated with dividend investing, including that dividend-issuing companies may choose not to pay a dividend, may not have the ability to pay, or the dividend may be less than what is anticipated.

Dividends are not guaranteed and must be authorized by the company's board of directors. Dividend-issuing companies are subject to interest rate risk. High dividends can sometimes signal that a company is in distress. Historically, dividend yields have been relatively constant and therefore have created a cushion for investors when stock prices have declined. However, as with all equity investing, there is the risk that a company will not achieve its expected earnings results, or that an unexpected change in the market or within the company will occur, both of which may adversely affect investment results. The biggest risk of equity investing is that returns can fluctuate and investors can lose money.

Definitions

Total return, when measuring performance, is the actual rate of return of an investment or a pool of investments over a given period. Total return includes interest, capital gains, dividends, and distributions realized over the specified period. Total return accounts for two categories of return: income including interest paid by fixed-income investments, distributions, or dividends and capital appreciation, representing the change in the market price of an asset.

Indices

The S&P 500 Index measures changes in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividends reinvested. The S&P 500 represents approximately 80% of the investable U.S. equity market.

Indices are unmanaged. One cannot invest directly in an index.

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411385 | 8/01/2024 | FL-EAM-DIVPAYERS