Why Dividend Growth Matters

EAGLE | Asset Management

June 2023

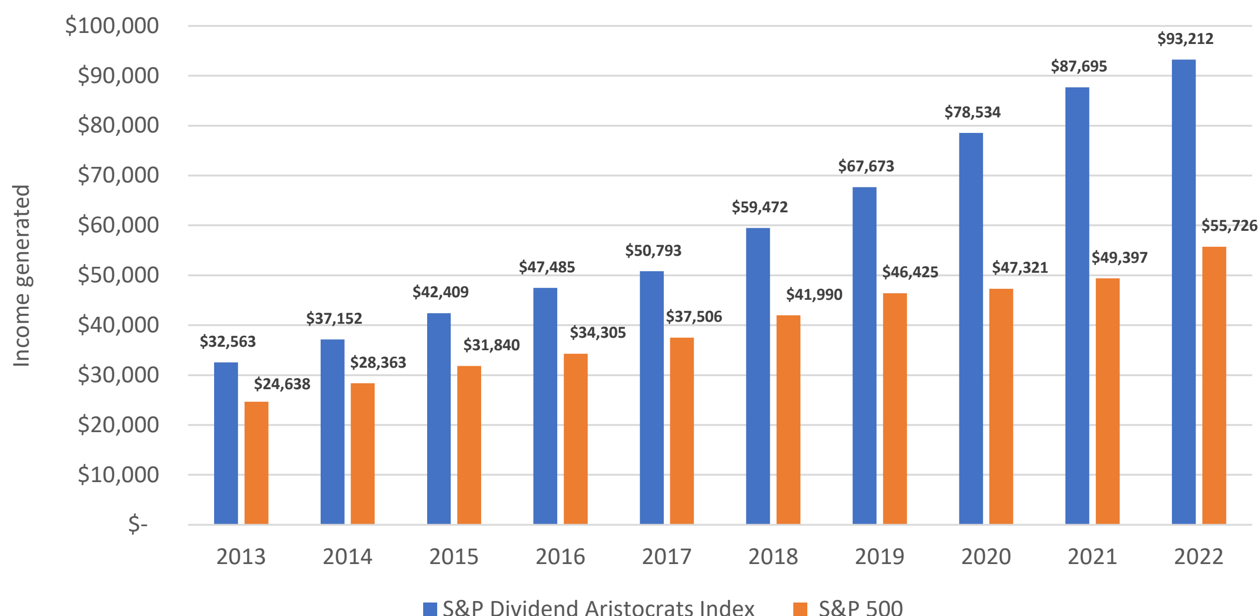
The hallmark of equity income investing at Eagle Asset Management can be found in the investment team's process-driven search for companies that have a history of, and are committed to, growing their dividends.

We believe that investments in these companies can be a powerful piece of a portfolio for any investor looking to achieve equity-like returns while also generating a high level of income that can compound over time.

In addition to providing that income, companies that are committed to growing their dividends tend to exhibit characteristics that many investors seek during periods of equity market selloffs. While negative returns are not a goal of any investor, it is important to recognize that investment portfolios will have periods of negative return. During these periods, protecting capital can be more important to your portfolio than trying to participate in rapidly rising markets. Always remember: To make up a 50% loss, a portfolio must return 100% to get back to even. It is in these periods when we believe you will see the importance of having a portfolio with an allocation to mature, blue-chip companies that have shown a dedication to growing their dividends.

Income generation

Dividend-paying stocks have become a bedrock of individual investor portfolios because of the level of income they can produce over time. Income can be a key contributor to total return and can thereby help investors achieve the portfolio growth they require to meet their spending needs. While dividend payments are important to meeting these goals, what often is missed is the power of investing in companies that sustainably grow their dividends and the effect that dividend growth can have on a portfolio's income generation over time. The chart below illustrates income generated by a theoretical $1,000,000 investment on 12/31/2012 in the S&P 500 Dividend Aristocrats® Index, which is composed of companies that have increased their dividends annually for 25 years, compared to the broad-market S&P 500 Index, with reinvestment assumed.



Source: Bloomberg, as of 12/31/22

Not FDIC Insured | May Lose Value | No Bank Guarantee

While historical, this illustration helps show that focusing not only on dividends but also on dividend growth can be essential to augmenting a portfolio's income stream over time.

Low risk and downside protection

Another key function of dividend-paying stocks is they tend to exhibit a defensive nature, which is important when preservation of wealth is necessary to sustain an income stream. The chart below focuses on periods starting at the end of a month when the S&P 500 saw at least a 15% drawdown from its previous peak and ending at the end of the month when the index returned to its previous high-water mark. It uses three dividend-oriented benchmarks to illustrate the importance of not only investing in companies that have a dividend, but also grow their dividend.

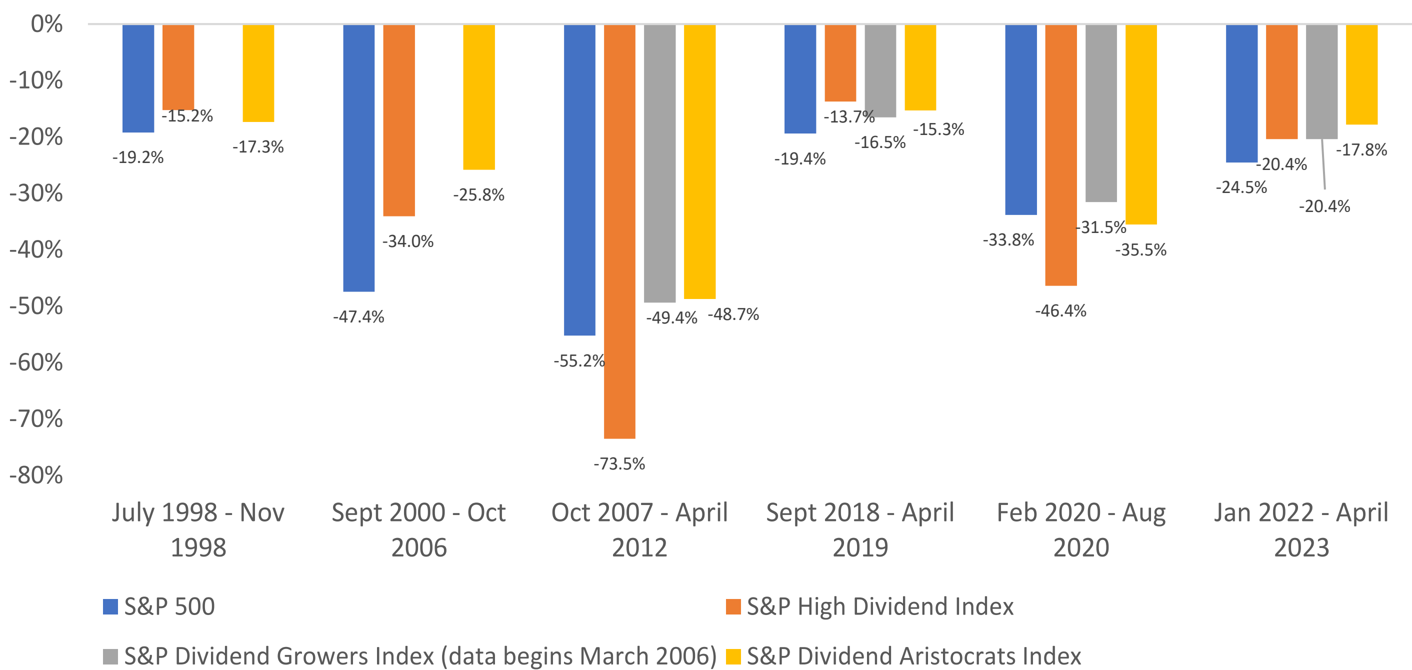
A close examination of the data reveals that indexes of dividend-paying companies have traditionally outperformed the broader market, as reflected by the S&P 500, during sustained drawdowns. There are two notable periods when this did not happen. Each time, the S&P High Dividend Index underperformed the S&P 500 by a broad margin. To understand why this could be the case, consider the growth prospects of the companies in the High Dividend Index. While high dividend payers can be attractive for immediate income, these companies traditionally pay the maximum dividends possible based on their cash flows, and that limits both reinvestment in their businesses and their growth going forward. In periods of stress, the market questions the sustainability of these high dividends and punishes any suspensions or cuts. In contrast, companies that focus on growing their dividends tend to pay conservative ratios while also reinvesting in their businesses to sustain growth opportunities. This helps them avoid selling off as much during similar periods.

Inflation protection

While inflation hadn't been a major concern for investors in the decades before 2022, it is notable that dividend growers have shown the ability to increase their dividends (your income stream) over time in excess of the rate of inflation.

Maximum drawdowns

S&P 500 versus Dividend-Paying Indexes



Source: Bloomberg, as of 4/28/2023

In conjunction with the other positive attributes of dividend-growing stocks, this feature has become increasingly important to investors who look to their portfolios for levels of income that exceed rising costs.

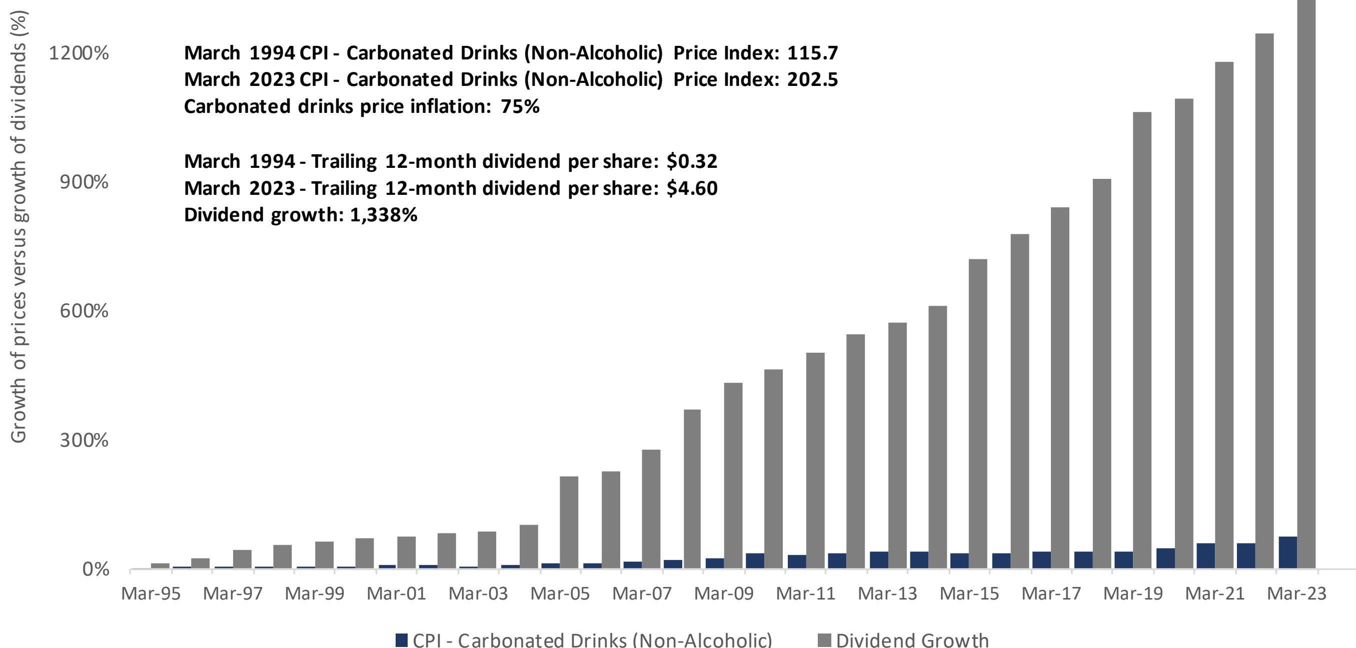
We believe dividend growth offers a range of benefits and has the potential to outpace inflation over time for at least three reasons:

- First, companies that prioritize dividend growth tend to be well established, financially stable, and to have track records of generating consistent profits. Such companies often operate in mature industries and have reliable cash flows that allow them to increase their dividends steadily. As a result, investors can benefit from a rising stream of income that has the potential to outpace inflation.
- Second, dividend growth reflects a company's commitment to sharing its success with shareholders. By consistently raising dividends, companies signal their confidence in future earnings growth and their willingness to reward long-term investors. This commitment can attract income-oriented investors who seek stable and growing streams of income, further boosting demand for the company's shares.
- Third, dividend growth investing aligns with the principle of compounding returns. Reinvesting dividends can accelerate a portfolio's growth, allowing shareholders to benefit from the power of compounding over time.

The chart below offers one example of the power of the compounding effect above the rate of inflation for underlying goods. It shows that a well-known soft drink company dedicated to growing its dividend has generated an income stream that has outpaced the rate of inflation for its underlying product over the long run. This compounding effect, when combined with dividend growth that outpaces inflation, can significantly enhance total returns and help investors maintain their purchasing power. Overall, we believe dividend growth can provide investors with a reliable and rising income stream, potential capital appreciation, and a hedge against inflation. In our view, these qualities make dividend growth an attractive strategy for long-term wealth accumulation.

Dividend growth: Outpacing soft drink inflation

Growth of soft drink prices versus dividend growth at one major bottler, 1994 to 2023



Source: Bloomberg, as of 3/31/2023

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

Compounding is the reinvestment of an asset's earnings, either from capital gains or from interest, to generate additional earnings over time. This growth is calculated using exponential functions and takes place because the reinvestment generates earnings from both the principal initially invested and the accumulated earnings from periods after that initial investment.

Total return, when measuring performance, is the actual rate of return of an investment or a pool of investments over a given period of time. 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.

Defensive stocks provide consistent dividends and stable earnings regardless whether the overall stock market is rising or falling. Companies with shares considered to be defensive tend to have a constant demand for their products or services and thus their operations are more stable during different phases of the business cycle.

The U.S. Consumer Price Index (CPI) measures the change in prices paid by consumers for goods and services. The U.S. Bureau of Labor Statistics bases the index on prices of food, clothing, shelter, fuels, transportation, doctors' and dentists' services, drugs, and other goods and services that people buy for day-to-day living. Prices are collected each month in 75 urban areas across the country from about 6,000 households and 22,000 retailers.

Trailing indicators are data or measurements that reflect events, trends, results, or developments that took place in the past. Trailing indicators typically refer to a specific time period for which the data in question is aggregated, summed, or averaged. Trailing indicators help reflect trends that occur over specified periods of time.

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.

The S&P 500 Dividend Aristocrats® Index measures the performance of S&P 500 companies that have increased dividends every year for the last 25 consecutive years. The index treats each constituent as a distinct investment opportunity without regard to its size by equally weighting each company.

The S&P 500 High Dividend Index serves as a benchmark for income-seeking equity investors. The index is designed to measure the performance of 80 high yield companies within the S&P 500 and is equally weighted to best represent the performance of this group, regardless of constituent size.

The S&P U.S. Dividend Growers Index is designed to measure the performance of U.S. companies that have followed a policy of consistently increasing dividends every year for at least 10 consecutive years. The index excludes the top 25% highest-yielding eligible companies from the index. The index was launched June 1, 2021, with value data hypothetically back-dated to March 17, 2006.

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

The views and opinions expressed are not necessarily those of any broker/dealer or any affiliates. Nothing discussed or suggested should be construed as permission to supersede or circumvent any broker/dealer policies, procedures, rules, and guidelines.

© 2023, Eagle Asset Management, Inc. All rights reserved.

880 Carillon Parkway | St. Petersburg, Florida 33716 | 1.800.235.3903 | eagleasset.com

393368 | 3/31/2024 | FL-EAM-DIVGROW