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## Equities

# Dividends avoid crisis in 2020 to face favorable dynamics in 2021

By: Derek DiGregorio | & Christopher B. Reed, CFA | March 8, 2021

**Boston** - While 2020 was a year of crisis for public health and the global economy, it seemed to have only a short-term impact on financial markets. S&P 500 Index dividends, which were prematurely dismissed last March, rose 0.7% for 2020, up from the previous record in 2019.<sup>1</sup> This compares to initial expectations that month for S&P 500 dividends to decrease by 28%.<sup>2</sup>

Looking out through 2021 and 2022, S&P 500 Index dividend expectations, based on dividend futures contracts, are working their way back up to the previous highs — off only about 8% from the all-time highs hit in February 2020.<sup>3</sup> We believe this sharp reversal in fortunes shows the market's confidence in the ability of companies to pay dividends as the global economy continues to reopen. Here are some factors we view as favorable for a dividend income strategy in this environment.

### **European special dividends**

Thus far into 2021, though our daily lives feel all too reminiscent of 2020, we have also been witnessing an interesting market development among non-U.S. companies — primarily in Europe, where many have been declaring special dividend payments.

Back in April 2020, amid some of the worst dividend-centric headlines we had seen in a decade, COVID lockdown restrictions prevented dozens of annual general meetings from *physically* taking place. As a result, annual dividends were unable to be ratified. Such a dynamic existed for nearly one-third of the STOXX® Europe 600 Index, with companies either postponing or suspending dividend payments for 2020.

By year-end 2020, however, roughly half of the affected companies within our defined investable universe ultimately paid a dividend in line with expectations. Furthermore, many of the companies that suspended dividends entirely for 2020 have already declared a "special" dividend in addition to the annual declared dividend for 2021 — effectively making shareholders whole for 2020, as well as conveying increased confidence to investors.

### **Higher interest rates and inflation**

The specter of higher interest rates has returned, as the 10-year U.S. Treasury yield has climbed above 1.5% and talk of an inflation scare in 2021 has moved to a consensus view. These two factors could lead to a difficult environment for clients in traditional fixed income.

In Europe, for example, the gaps in yield between equity dividends and both corporate and sovereign bonds remain historically elevated at around 1.9% and 2.7%, respectively.<sup>4</sup>

Historically, dividend growth rates have held up well against inflation. Since 1970, the MSCI World Index has seen dividends increase at a rate of 5% annually, compared to a U.S. Consumer Price Index (CPI-U) measure of inflation at 3.9% over the same period.<sup>5</sup>

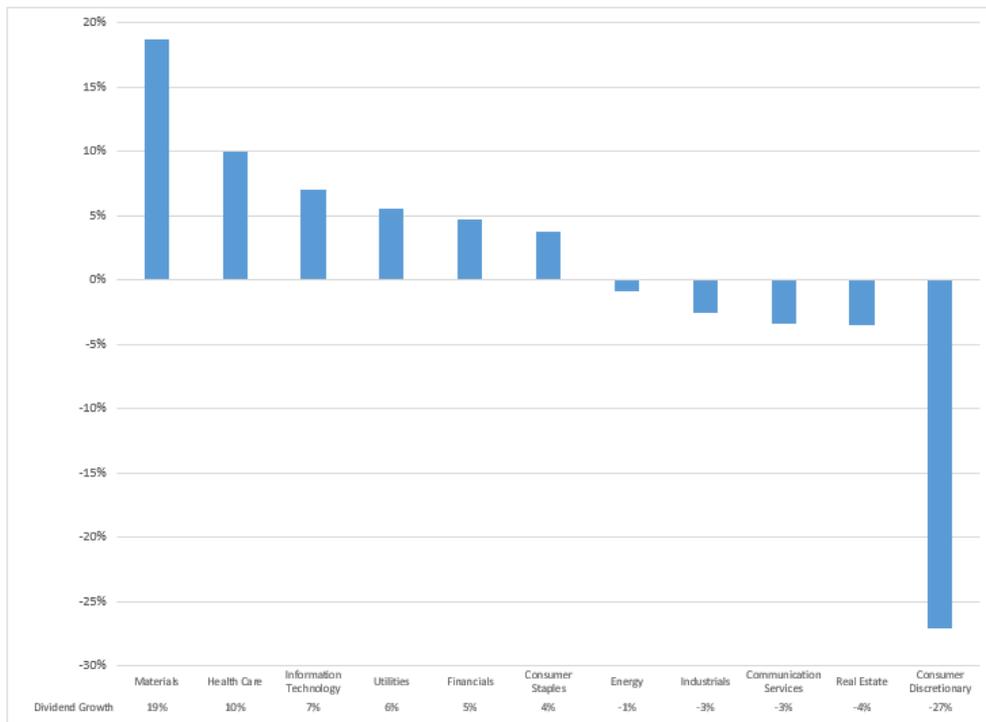
Given these dynamics, income-focused investors may want to consider dividend-focused strategies for an income stream that could be higher and better protected against the damaging effects of inflation.

### **Core tenets of a dividend income strategy**

With this in mind, we remind ourselves that not all dividend strategies are created equal. Stretching for yield can be more precarious in less predictable market environments. That's why we think the core tenets of a successful dividend income strategy have not changed: fundamental research, diversification and a rules-based approach.

Looking at 2020 dividend growth by sector in the S&P 500 highlights the importance of a diversified approach. Strategies or benchmarks that focus too heavily on traditionally higher yielding sectors — such as energy, real estate and consumer stocks — could leave investors empty handed.

### **S&P 500 dividend growth by economic sector in 2020**



Source: FactSet from 12/31/2019 to

12/31/2020. Data provided is for informational use only. It is not possible to invest directly in an index. Past performance is no guarantee of future results.

Strategies that employ an approach known as *dividend capture* may be able to take advantage of the resulting increase in yields if equity prices decrease, while still seeking to generate the same high level of sustainable tax-advantaged dividend income.

**Bottom line:** We believe strategies that focus on a company's ability and willingness to pay — ever under a stressful macro environment — and manage exposures at the company, sector and country level may help to provide more stable returns and more consistent income over time.

1. Dividends payments rose 0.7% to \$58.28 per share from the previous record set in 2019, according to S&P Global. <https://www.reuters.com/article/us-usa-stocks-dividend/sp-dividend-payments-to-investors-hit-record-in-2020-despite-virus-hit-idUSKBN29421J>
2. By the end of February 2020, expectations had inched up to \$61.40 before nosediving as the economy plummeted into a coronavirus-induced contraction. Through March, expectations shifted to a 28% drop in 2020 dividends relative to 2019 — an outcome that would have set a record for negative growth in S&P 500 dividends in a calendar year. <https://www.wisdomtree.com/blog/2020-12-11/2020-dividends-a-year-in-review>
3. FactSet as of February 28, 2021.
4. Citi Private Bank, Europe Strategy bulletin, "European dividends should outperform in 2021," January 22, 2021.
5. Ned Davis Research, FactSet as of December 31, 2020.

**S&P 500 Index** is an unmanaged index of large-cap stocks commonly used as a measure of U.S. stock market performance.

**STOXX® Europe 600 Index** is an unmanaged index representing large, mid and small capitalization companies across 17 countries of the European region: Austria, Belgium, Denmark, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

**MSCI World Index** is an unmanaged index of equity securities in the developed markets.

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