E|V|M Eaton Vance Management

Timely insights from portfolio managers and industry experts on key financial, economic and political issues.

MARCH 8, 2021

Equities

Dividends avoid crisis in 2020 to face favorable dynamics in 2021

Picture of **Derek DiGregorio**
Equity Strategy Implementation and Portfolio Manager
Eaton Vance Management

Picture of **Christopher B. Reed, CFA**
Product & Portfolio Strategy

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.[1] This compares to initial expectations that month for S&P 500 dividends to decrease by 28%.[2]

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.[3] 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.

"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."

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.[4]

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.[5]

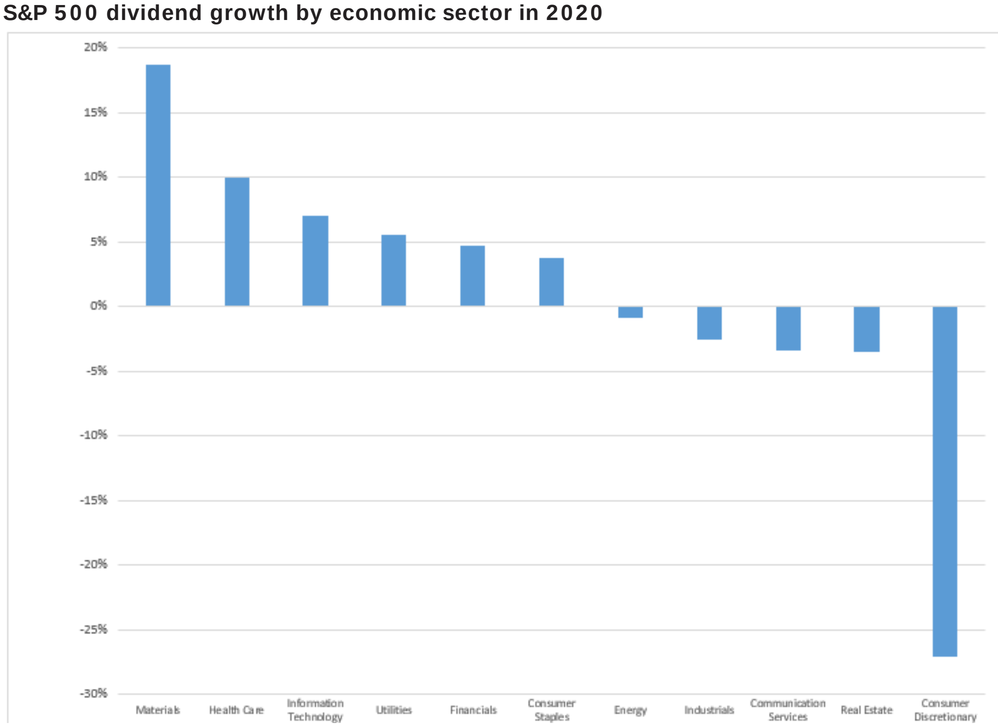
Given these dynamics, income-focused investors may want to consider dividend-focused strategies for an income stream that could be higher and better protected against the damaging effects of inflation.

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



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.

It is not possible to invest directly in an index. Past performance is not a guarantee of future results.

All investing involves risk, including the risk of loss.

The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the U.S. and global markets. The value of equity securities is sensitive to stock market volatility. Investments in foreign instruments or currencies can involve greater risk and volatility than U.S. investments because of adverse market, economic, political, regulatory, geopolitical, currency exchange rates or other conditions.