

# Dividend investing in a volatile market

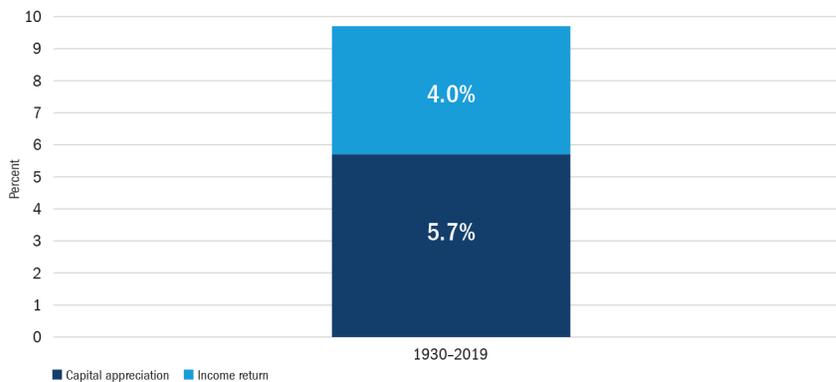
April 23, 2020

*U.S. companies are cutting or suspending dividends at a rate not seen since the global financial crisis. But investors should remain focused on the longer term performance.*

Dividends have historically been an important component of equity total return. In the beginning of 2020, we believed their contribution would rise relative to equity price returns, which we expected to be lower.

## ▶ U.S. equity market average annual return: Income vs. capital appreciation

Going back to 1930, 40% of the S&P 500's return has come from dividend income



Source: Ned Davis Research as of 12/31/19. U.S. equities represented by the S&P 500 Index, tracks the performance of 500 widely held, large-capitalization U.S. stocks. Past performance is not a guarantee of future results. It is not possible to invest directly in an index.

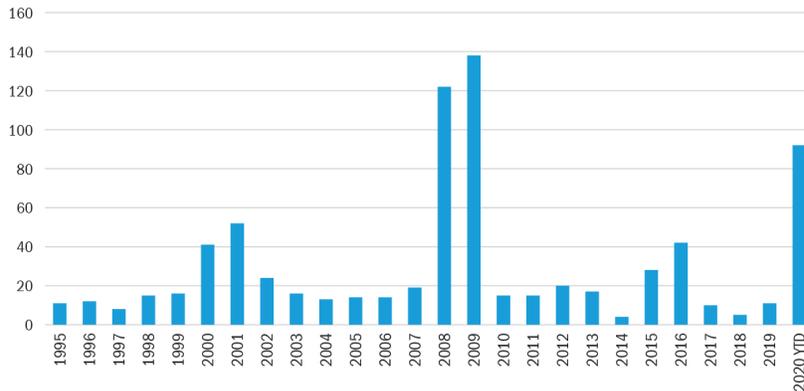
But now, given the pressures of the pandemic-related economic slowdown, companies looking for ways to conserve cashflow are targeting dividend payments. The number of companies that have announced a cut and/or suspension of dividends is now at its highest level since the global financial crisis (GFC).



Columbia Threadneedle  
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▶ **There's a spike in the number of companies announcing dividend cuts**

S&P 500 dividend cuts or suspensions



Source: Wolfe Research as of April 8, 2020. Companies in the S&P 500 Index announcing a dividend cut or suspension.

While the comparison to the GFC may make for a good headline, there are important distinctions to bear in mind. Most important is that, unlike the crisis of 2008, which was largely focused on one sector of the economy, the economic shutdown implemented to contain the virus is impacting almost all businesses. Many companies that were otherwise assumed to be strong have had to reassess their financial strategies. The impact is particularly severe for industries such as travel and leisure, but by virtue of the pervasiveness of the shutdown, it's not surprising to see a higher number of announced cuts and suspensions.

**Dividend cuts vs. suspensions**

When a company **cuts** their dividend, they commit to continuing their payout, but at a lower rate than was previously distributed. While hardly ideal for income-oriented investors, a cut may be viewed as preferential to an outright suspension.

In a **suspension**, the company discontinues its payout with the expectation that it may restart at a later date. A suspension may be viewed as more troubling by the market as historically only about 20% of companies suspending their dividend reinitiate a payout during the following 5 years.<sup>1</sup>

**What to expect going forward**

We expect to see further dividend cuts or suspension announcements during the upcoming earnings season. In particular, companies with higher leverage, or those that have been funding their dividends through means other than high free cash flow, may be more likely to announce cuts or suspensions.

While some companies use their dividend policy to reward investors for participating in their company's growth, others use their policy to support the stock price because their earnings growth is insufficient. It's these latter companies (outside of those more directly impacted by the slowdown) that are now under greater pressure to cut or suspend dividends as a way to conserve cash. In certain cases, companies accepting federal aid (in the form of grants or loans) as part of the CARES Act will have no choice but to cut or suspend their dividend — programs have made "no payouts or buybacks" a condition of receiving aid.

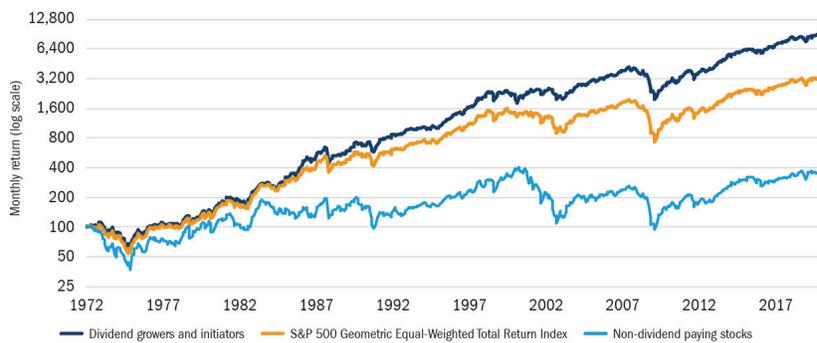
Dividend cut levels will likely approach and may exceed the GFC era, led by cuts in energy and certain consumer areas. The big U.S. banks, the epicenter of the 2008-2009 market crisis, have entered this crisis in a strong capital position — well in excess of the Fed’s regulatory capital minimums. We don’t expect a raft of cuts here, but will continue to watch this sector closely.

**Keep performance in perspective**

We believe that it’s critical for investors to remain focused on the longer term performance of dividend stocks. Over the long term, companies that grow and initiate dividends have outperformed the S&P 500 Index annual average gain of 6.9%.<sup>2</sup> And looking at the last three recessions, dividend initiators and growers in the S&P 500 were able to outperform non-dividend stocks, as well as the index overall.<sup>3</sup>

▶ **Sustainable dividends drive long-term growth**

S&P 500 Index returns by dividend policy



Source: Ned Davis Research data as of 3/31/2020. Past performance is not a guarantee of future results. The S&P 500 Index, tracks the performance of 500 widely held, large-capitalization U.S. stocks. It is not possible to invest directly in an index. There is no guarantee that these trends will continue. This information is intended for illustrative purposes only. It is not intended to be representative of specific portfolio holdings. Dividend growers and initiators represents those companies in the S&P 500 Index that have either grown their cash dividend or initiated one over the last 12 months. Non-dividend-paying stocks are those in the Index that have not paid dividends in the last 12 months.

**Bottom line: What works for dividend investors**

This is an unusual environment. Even healthy companies are being pressured to cut or suspend dividend payments. Intense research is critical to uncovering opportunities for long-term investors. This means focusing on companies with high free cash flows (normalized) and healthy balance sheets. These companies may be more likely to successfully weather a recession without having to cut dividend payments. As always, we advise against chasing the highest yielding stocks. Yield for the sake of yield is typically not a sound investment strategy — stocks that are higher yielding, but without underlying earnings growth to support the dividend, may be more likely to see a cut or suspension.

<sup>1</sup> Source: Wolfe Research, S&P 500, 1997-2019

<sup>2</sup> Source: Columbia Threadneedle Investments based on Ned Davis Research data for the period 01/01/1972 - 3/31/2020.

<sup>3</sup> Source: Columbia Threadneedle Investments. Last three recessions determined by the National Bureau of Economic Research: July 1990 – March 1991; March 2001 – November 2001; December 2007 – June 2009.

Dividend payments are not guaranteed and the amount, if any, can vary over time. Market risk may affect a single issuer, sector of the economy, industry or the market as a whole.

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