# The essentials of dividend investing: A conversation with three dividend investing experts, Part 2 of 2

October 28, 2019

*We sat down with portfolio managers, Scott Davis, Mike Barclay and Pete Santoro to get their most relevant insights on dividend investing today.*

Read Part 1 of the Dividend Investing Q&A

Scott Davis
Senior Portfolio Manager and Head of Income Strategies

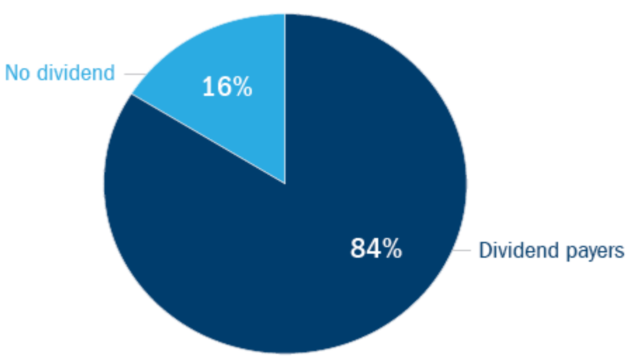
Mike Barclay, CFA
Senior Portfolio Manager

Pete Santoro, CFA
Senior Portfolio Manager

**How has dividend investing evolved as a strategy over time?**

**PETE SANTORO:** In the past, when people thought about dividend income investing, they were looking at a couple sectors — for example, utilities or consumer staples — because that's where most of the dividend growth could be found. But as capital allocation policies throughout the market have evolved, we've seen opportunity in all sectors. Now, investors can build a more diversified portfolio because they can find income and income growth outside of core interest-rate sensitive sectors.

**Most S&P stocks — not just cyclical and defensive ones — pay dividends**




Source: Columbia Threadneedle Investments. 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.

**What are dividend traps and how can investors avoid them?**

**MIKE BARCLAY:** They're typically stocks that are higher yielding, but without underlying earnings growth to support dividend growth. In some instances, they don't even support the current dividend. You can avoid dividend traps by asking if the company can sustain the dividend over time. It's also important to look at how much of the cash flow the dividend is consuming. If the dividend isn't stressing the cash flows, then typically an investor can avoid the dividend trap.

**What are the critical questions you ask in evaluating dividend stocks?**

**SCOTT DAVIS:** What drives the cash flow. Oftentimes investors have no understanding of how the dividend gets sourced. Dividends have to be paid out of current or retained earnings. Governance also matters. Is the management team being upfront? You want a management team that acts as a good partner that you can trust. How is capital deployed? How is the distribution of cash flow prioritized? We want to see reinvestment back into the business. What do debt and leverage look like? Do they understand the business? Has the management team done buybacks at a reasonable price relative to the intrinsic value of the corporation? Debt payment is also important. Is it sustainable? You don't want the bondholders to be controlling your destiny. You want to see a rational dividend policy.

**Can the prospect of a dividend cut be identified in advance?**

**SCOTT DAVIS:** We think it can, and it's important to do the work to try to identify the cut. There are a couple early indicators. Find out if there's falling cash flow from operations, since that's the source of dividends. Take a look a credit reviews — if a corporation has taken on too much debt, rating agencies may question its ability to meet its obligations. Pay attention to price volatility, especially downside volatility. The average dividend cutter is down almost 20% in the 12 months prior to the cut.[1] As an investor, that loss of principal can impede the ability to generate income.

**What should an equity income investor expect in a period of increased market volatility?**

**MIKE BARCLAY:** Volatility comes in a lot of shapes and sizes — it can be sector rotation or style rotation, and that's where taking a long-term view is very important because it allows you to navigate both. People care more about downside volatility than upside, so protecting on the downside is important. A steady, consistent process focused on long-term wealth building is important for navigating short-term movements.

**SCOTT DAVIS:** Historically, dividend-paying stocks have done better than non-dividend payers in volatile markets. Dividends are defensive, but only if the business model is sustainable. It goes back to a company's ability to generate cash from operations. The balance sheet is very important because you don't want exposure to companies that are overly indebted, especially in times of volatility. Companies don't want to be forced to go to the capital markets for financing in these circumstances.

*In case you missed it: Read Part 1 of The essentials of dividend investing*

[1] Source: Wolfe Research Accounting & Tax Policy Research as of March 2019, updated annually. The universe includes Russell 3000 companies, excluding <$250 million market capital companies since 1995. Measurement date from 5 days after the cut announcement. Past performance is not a guarantee of future results. 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. The Russell 3000 Index measures the performance of the 3,000 largest publicly held companies incorporated in America as measured by total market capitalization. It is not possible to invest directly in an index.

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