LORD ABBETT®

September 3, 2024

Markets & Economies

Dividend Growers: The Importance of Yield-on-Cost

While current yield is a key consideration, we think it's essential to focus on the potential future income of an investment in dividend-paying stocks.

Darnell Azeez, CFA
Partner,
Portfolio Manager

Subrata Ghose, CFA
Portfolio Manager

Jeffrey Rabinowitz, CFA
Portfolio Manager

JJ Titus, CFA
Product Specialist

IN BRIEF

- With uncertainty around future interest rates and market volatility, investors may be searching for alternative sources of income. We think one source worth considering is U.S. dividend-paying stocks.
- While current dividend yield is a focal point for investors, we think it is more important to consider the future income that could be generated by dividend stocks—especially those with a long-term history of annual dividend increases.
- We believe one important measure in that regard is yield-on-cost, which is annual income relative to the originally invested amount.
- Future dividend income can potentially be enhanced by employing an active manager with experience in selecting quality dividend growth stocks.

When researching dividend-paying stocks, investors often focus on the current dividend yield—the rate of payout their investment is generating now. This is understandable, as a typical goal of a dividend-focused investor is to generate current income. But only paying attention to the current yield misses out on what we believe is the real power of dividends: the potential growth of future income from your investment. For dividend stocks, we think this concept is best illustrated by a metric known as *yield-on-cost*, which we believe has several strategic advantages over merely focusing on current yield.

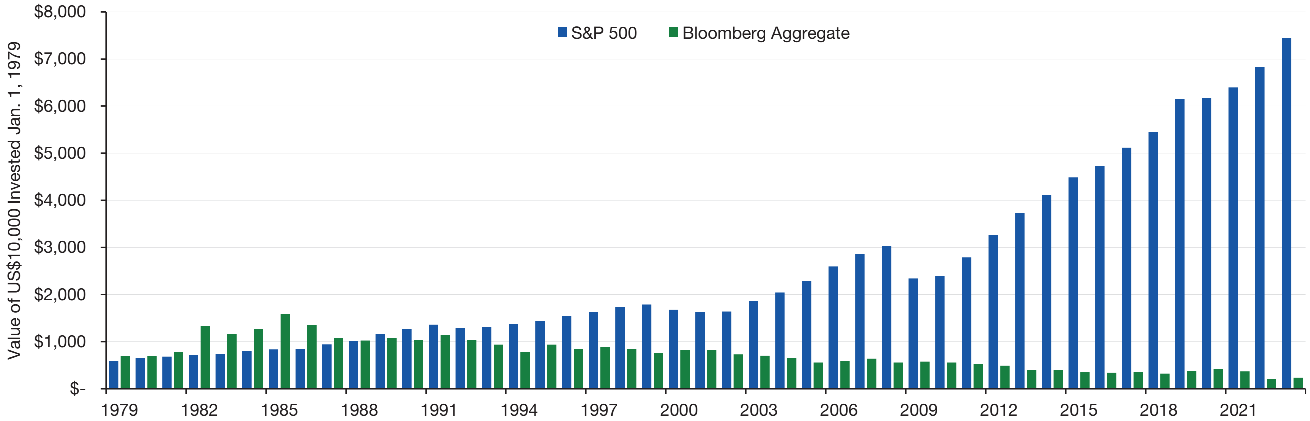
Yield-on-cost is calculated by dividing the annual dividend income by the original purchase price of the investment. This measure reflects how much an investor is earning on their initial investment over time. Looking through this lens can help illustrate the potential for the long-term growth in income from dividend-paying stocks.

Rising Dividends, Rising Income

A good way to visualize this concept is to compare the income generated over time by an initial investment of $10,000 in each of the S&P 500® Index and the Bloomberg U.S. Aggregate Bond Index (see Figure 1). Investments in bonds and related vehicles like bond-index funds are expected to produce higher current income as compared to dividend stocks, and we see this behavior in the first few years depicted in the chart. Yet over time, the earnings growth of the S&P 500 companies leads to higher annual income. (The ending market value figures reflect price appreciation only, as the chart assumes that dividends are being withdrawn each year.)

Figure 1. Comparing Income Generated by Bonds and Dividend Stocks Over the Long Term

Annual dividend income (S&P 500) and interest income (Bloomberg Aggregate) on $10,000 invested on January 1, 1979 (1979-2023)



	Initial Investment	First Year Income	Final Year Income	Ending Value	Ending Yield on Cost
S&P 500 Index	$10,000	$588	$7,444	$496,289	74.44%
Bloomberg U.S. Aggregate Bond Index	$10,000	$696	$236	$10,155	2.36%

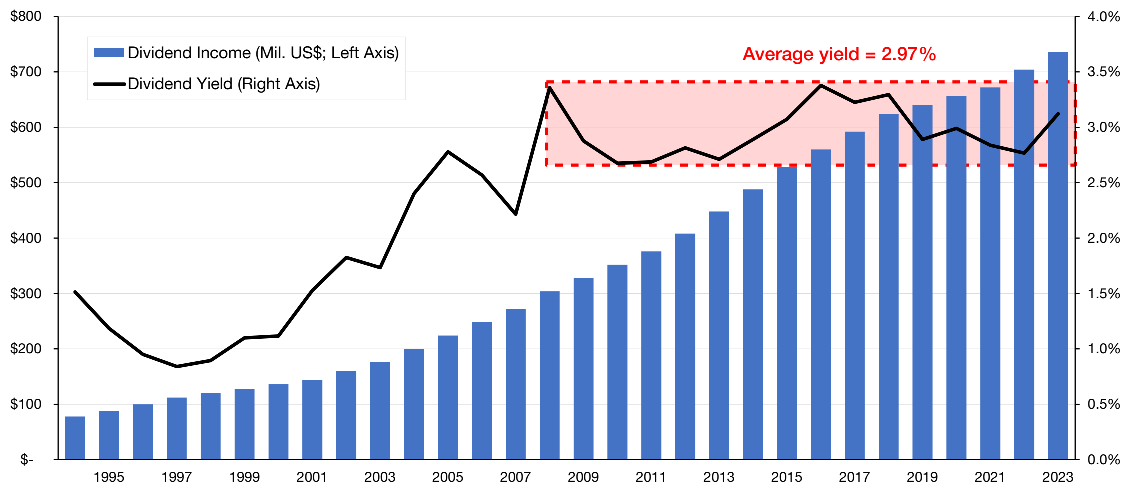
Source: FactSet. A company's dividend payments may vary over time, and there is no guarantee that a company will pay a dividend at all. **Past performance is not a reliable indicator or guarantee of future results.** For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. Indexes are unmanaged, do not reflect the deduction of fees and expenses, and are not available for direct investment.

It is important to note that over this time horizon, the S&P 500 dividend yield averaged 2.5% while the yield on the Aggregate Index averaged 6.7%. But if we focus on yield-on-cost, we see that our initial investment in the stock market is yielding *more than 74%* as compared to its bond alternative at 2.36%.

The experience of one of the most well-known investors of our time, Warren Buffett, underscores the importance of yield-on-cost. In 1994, Buffett's company, Berkshire Hathaway, completed a seven-year purchase of Coca-Cola shares for $1.3 billion. The cash dividends from that investment produced $75 million of income for Berkshire in 1994. As of this writing, Coke's current yield is around 3% and has been for the last 15 years (see Figure 2). While some may see the stagnant yield as a detriment, the annual dividend has grown 242% while the stock price appreciated by 160% over this period. As a result, those cash payouts grew to $736 million by 2023, resulting in a yield of 57% on the initial investment. Should the soft-drink giant continue its multi-decade run of sustainable growth and annual dividend hikes, the yield on cost will continue to increase as well.

Figure 2. Dividend Increases Fueled Rising Income from Coke Shares Even as Yield Remained in Narrow Range

Berkshire Hathaway's annual dividend income from its mid-1990s Coca-Cola investment (left axis) and Coca-Cola's dividend yield over time (right axis), 1994-2023



Source: FactSet. A company's dividend payments may vary over time, and there is no guarantee that a company will pay a dividend at all. **Past performance is not a reliable indicator or guarantee of future results.** For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. Indexes are unmanaged, do not reflect the deduction of fees and expenses, and are not available for direct investment.

Quality Counts

The Coke example highlights the importance of finding quality companies within the dividend-paying universe. Within the universe of dividend-paying stocks, we believe investors can benefit by focusing on companies with a long history of dividend growth. These companies typically have stable earnings, robust cash flows, and a disciplined approach to returning capital to shareholders. This focus naturally aligns with selecting quality stocks that can sustain and grow their dividends over time, reducing the risk of income instability. In contrast, a focus on current yield may lead investors toward higher-yielding, but potentially riskier, companies.

Research has shown that the companies with the highest dividend yields have historically lagged the broader universe of dividend-paying stocks. These companies can face high volatility dealing with challenges maintaining its dividend or can have limited equity market participation as “bond proxies” (securities in sectors like real estate, utilities, and consumer staples that have high valuations with relatively low earnings growth). In addition, these “bond proxies” tend to be very interest-rate sensitive and can face headwinds during periods of rate volatility.

We think the potential long-term benefits of dividend-paying stocks are clear. However, we believe a thoughtful approach to dividend investing is vital to accessing these benefits while balancing risk and reward. We believe it is important to target quality companies that are not only willing to increase their dividend but are also able to do so in a manner that keeps their future growth intact.

LORD ABBETT®

Important Information

Unless otherwise noted, all discussions are based on U.S. markets and U.S. monetary and fiscal policies.

References to fund yields are for informational purposes only and are not meant to represent any specific Lord Abbett bond fund or portfolio.

Asset allocation or diversification does not guarantee a profit or protect against loss in declining markets.

No investing strategy can overcome all market volatility or guarantee future results.

The value of investments and any income from them is not guaranteed and may fall as well as rise, and an investor may not get back the amount originally invested. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon, and risk tolerance.

Market forecasts and projections are based on current market conditions and are subject to change without notice.

Projections should not be considered a guarantee.

Dividends are not guaranteed and may be increased, decreased, or suspended altogether at the discretion of the issuing company.

Dividend policy: A stock is classified as a dividend payer if it paid a cash dividend any time during the previous 12 months; a dividend grower if it initiated or raised its cash dividend at any time during the previous 12 months; and a non-dividend payer if it did not pay a cash dividend at any time during the previous 12 months.

Equity Investing Risks

The value of investments in equity securities will fluctuate in response to general economic conditions and to changes in the prospects of particular companies and/or sectors in the economy. While growth stocks are subject to the daily ups and downs of the stock market, their long-term potential as well as their volatility can be substantial. Value investing involves the risk that the market may not recognize that securities are undervalued, and they may not appreciate as anticipated. Smaller companies tend to be more volatile and less liquid than larger companies. Small cap companies may also have more limited product lines, markets, or financial resources and typically experience a higher risk of failure than large cap companies.

Fixed-Income Investing Risks

The value of investments in fixed-income securities will change as interest rates fluctuate and in response to market movements. Generally, when interest rates rise, the prices of debt securities fall, and when interest rates fall, prices generally rise. High yield securities, sometimes called junk bonds, carry increased risks of price volatility, illiquidity, and the possibility of default in the timely payment of interest and principal. Bonds may also be subject to other types of risk, such as call, credit, liquidity, and general market risks. Longer-term debt securities are usually more sensitive to interest-rate changes; the longer the maturity of a security, the greater the effect a change in interest rates is likely to have on its price.

The credit quality of fixed-income securities in a portfolio is assigned by a nationally recognized statistical rating organization (NRSRO), such as Standard & Poor's, Moody's, or Fitch, as an indication of an issuer's creditworthiness. Ratings range from 'AAA' (highest) to 'D' (lowest). Bonds rated 'BBB' or above are considered investment grade. Credit ratings 'BB' and below are lower-rated securities (junk bonds). High-yielding, non-investment-grade bonds (junk bonds) involve higher risks than investment-grade bonds. Adverse conditions may affect the issuer's ability to pay interest and principal on these securities.

Glossary & Index Definitions

The **Bloomberg U.S. Aggregate Bond Index** represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment-grade, fixed-rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.

<u>Bloomberg Index Information</u>

Source: Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). Bloomberg owns all proprietary rights in the Bloomberg Indices. Bloomberg does not approve or endorse this material or guarantee the accuracy or completeness of any information herein, or make any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, shall not have any liability or responsibility for injury or damages arising in connection therewith.

The **S&P 500® Index** is widely regarded as the standard for measuring large cap U.S. stock market performance and includes a representative sample of leading companies in leading industries.

Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment

This material may contain assumptions that are "forward-looking statements," which are based on certain assumptions of future events. Actual events are difficult to predict and may differ from those assumed. There can be no assurance that forward-looking statements will materialize or that actual returns or results will not be materially different from those described here.

The views and opinions expressed are as of the date of publication, and do not necessarily represent the views of the firm as a whole. Any such views are subject to change at any time based upon market or other conditions, and Lord Abbett disclaims any responsibility to update such views. Lord Abbett cannot be responsible for any direct or incidental loss incurred by applying any of the information offered.

This material is provided for general and educational purposes only. It is not intended as an offer or solicitation for the purchase or sale of any financial instrument, or any Lord Abbett product or strategy. References to specific asset classes and financial markets are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations or investment advice.

Please consult your investment professional for additional information concerning your specific situation.

<u>Important Information for U.S. Investors</u>

Lord Abbett mutual funds are distributed by Lord Abbett Distributor LLC.

FOR MORE INFORMATION ON ANY LORD ABBETT FUNDS, CONTACT YOUR INVESTMENT PROFESSIONAL OR LORD ABBETT DISTRIBUTOR LLC AT 888-522-2388, OR VISIT US AT LORDABBETT.COM FOR A PROSPECTUS, WHICH CONTAINS IMPORTANT INFORMATION ABOUT A FUND'S INVESTMENT GOALS, SALES CHARGES, EXPENSES AND RISKS THAT AN INVESTOR SHOULD CONSIDER AND READ CAREFULLY BEFORE INVESTING.

The information provided is not directed at any investor or category of investors and is provided solely as general information about Lord Abbett's products and services and to otherwise provide general investment education. None of the information provided should be regarded as a suggestion to engage in or refrain from any investment-related course of action as neither Lord Abbett nor its affiliates are undertaking to provide impartial investment advice, act as an impartial adviser, or give advice in a fiduciary capacity. If you are an individual retirement investor, contact your financial advisor or other fiduciary about whether any given investment idea, strategy, product or service may be appropriate for your circumstances.

LORD ABBETT®

Important Information for non-U.S. Investors

Note to Switzerland Investors: In Switzerland, the Representative is ACOLIN Fund Services AG, Leutschenbachstrasse 50, CH-8050 Zurich, whilst the Paying Agent is Bank Vontobel Ltd., Gotthardstrasse 43, CH-8022 Zurich. The prospectus, the key information documents or the key investor information documents, the instrument of incorporation, as well as the annual and semi-annual reports may be obtained free of charge from the representative. In respect of the units offered in Switzerland, the place of performance is at the registered office of the representative. The place of jurisdiction shall be at the registered office of the representative or at the registered office or domicile of the investor.

Note to European Investors: This communication is issued in the United Kingdom and distributed throughout the European Union by Lord Abbett (Ireland) Limited, UK Branch and throughout the United Kingdom by Lord Abbett (UK) Ltd. Both Lord Abbett (Ireland) Limited, UK Branch and Lord Abbett (UK) Ltd are authorized and regulated by the Financial Conduct Authority.

A decision may be taken at any time to terminate the arrangements made for the marketing of the Fund in any EEA Member State in which it is currently marketed. In such circumstances, Shareholders in the affected EEA Member State will be notified of this decision and will be provided with the opportunity to redeem their shareholding in the Fund free of any charges or deductions for at least 30 working days from the date of such notification.

Lord Abbett (Middle East) Limited is authorised and regulated by the Dubai Financial Services Authority ("DFSA"). The entire content of this document is subject to copyright with all rights reserved. This research and the information contained herein may not be reproduced, distributed or transmitted in any jurisdiction or to any other person or incorporated in any way into another document or other material without our prior written consent. This document is directed at Professional Clients and not Retail Clients. Any other persons in receipt of this document must not rely upon or otherwise act upon it. This document is provided for informational purposes only. Nothing in this document should be construed as a solicitation or offer, or recommendation, to acquire or dispose of any investment or to engage in any other transaction. Nothing contained in this document constitutes an investment, an offer to invest, legal, tax or other advice or guidance and should be disregarded when considering or making investment decisions.

Note to Singapore Investors: Lord Abbett Global Funds I plc (the "Company") and the offer of shares of each sub-fund of the Company do not relate to a collective investment scheme which is authorized under Section 286 of the Securities and Futures Act, Ch. 289 of Singapore ("SFA") or recognized under Section 287 of the SFA, and shares in each sub-fund of the Company are not allowed to be offered to the retail public. Pursuant to Section 305 of the SFA, read in conjunction with Regulation 32 of and the Sixth Schedule to the Securities and Futures (Offers of Investments) (Collective Investment Schemes) Regulations 2005 (the "Regulations"), the Lord Abbett Global Multi-Sector Bond Fund, the Lord Abbett High Yield Fund, the Lord Abbett Short Duration Income Fund, the Lord Abbett Ultra Short Bond Fund, the Lord Abbett Climate Focused Bond Fund, the Lord Abbett Emerging Markets Corporate Debt Fund and the Lord Abbett Multi Sector Income Fund have been entered into the list of restricted schemes maintained by the Monetary Authority of Singapore for the purposes of the offer of shares in such sub-funds made or intended to be made to relevant persons (as defined in section 305(5) of the SFA), or, the offer of shares in such sub-funds made or intended to be made in accordance with the conditions of section 305(2) of the SFA. These materials do not constitute an offer or solicitation by anyone in Singapore or any jurisdiction in which such an offer or solicitation is not authorized or to any person to whom it is unlawful to make such an offer or solicitation.

Note to Hong Kong Investors: The contents of this material have not been reviewed nor endorsed by any regulatory authority in Hong Kong. An investment in the Fund may not be suitable for everyone. If you are in any doubt about the contents of this material, you should consult your stockbroker, bank manager, solicitor, accountant or other financial adviser for independent professional advice. The Fund is not authorised by the Securities and Futures Commission ("SFC") in Hong Kong pursuant to Section 104 of the Securities and Futures Ordinance (Cap 571, Laws of Hong Kong) ("SFO"). This material has not been approved by the SFC in Hong Kong, nor has a copy of it been registered with the Registrar of Companies in Hong Kong and, must not, therefore, be issued, or possessed for the purpose of issue, to persons in Hong Kong other than (1) professional investors within the meaning of the SFO (including professional investors as defined by the Securities and Futures (Professional Investors) Rules); or (2) in circumstances which do not constitute an offer to the public for the purposes of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32, Laws of Hong Kong) or the SFO. This material is distributed on a confidential basis and may not be reproduced in any form or transmitted to any person other than the person to whom it is addressed.

Lord, Abbett & Co. LLC | 30 Hudson Street | Jersey City, NJ 07302-4804 | T 1.888.522.2388 | lordabbett.com

ME-YIELD_COST
08-24