Dividend Stocks May Be an Effective Response to Market Uncertainty

Dividend-paying equities, especially those with a consistent history of dividend growth, may be well-positioned to weather a period of slowing growth and high inflation.

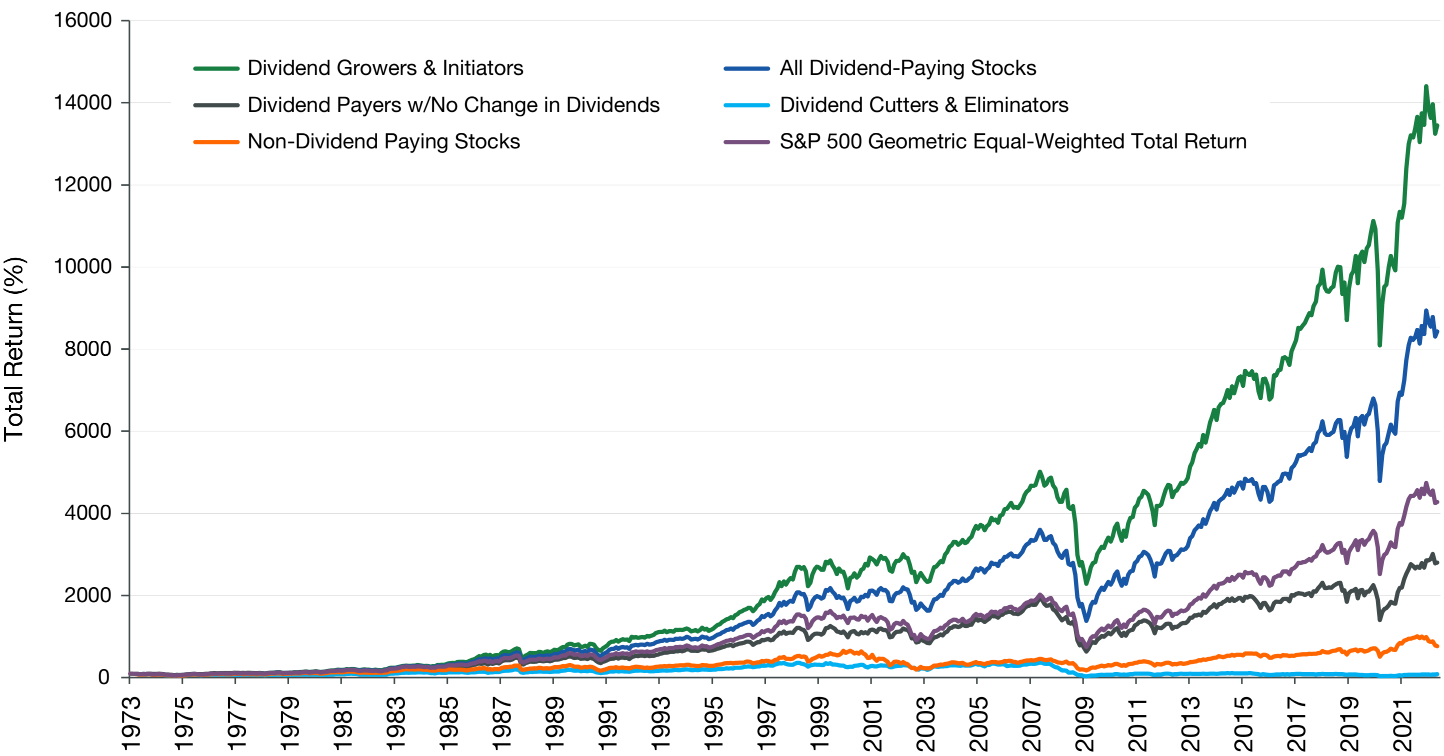
Featured Contributors

Servesh Tiwari, CFA,
Portfolio Manager

Melanie Coffin, CFA,
Associate Investment Strategist

Figure 1. Dividend Growers Have Outperformed Over the Past Five Decades

Total return by dividend policy (as defined) for companies in the S&P 500® Index, January 1973–May 2022 (monthly data)



Source: Ned Davis Research. Data as of May 31, 2022. Dividend growers & initiators=Companies that have initiated, and steadily grown, dividends. Dividend cutters & eliminators= Companies that have cut or eliminated dividends. Dividend payers with no change in dividends=Companies that have paid, but not grown or reduced dividends. Geometric equal-weighted total return represents the compounded annual growth rate or time-weighted rate of return for an equally weighted index. A company's dividend payments may vary over time, and there is no guarantee that a company will pay a dividend at all.

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As the second half of 2022 begins, investors are faced with a mosaic of uncertainty. High and persistent inflation has a motivated—and hawkish—U.S. Federal Reserve (Fed) raising rates and initiating quantitative tightening. Meanwhile, concerns continue to mount about the future direction of the U.S. economy, with measures of consumer confidence sharply lower and economic indicators pointing to slowing growth, and possibly, a recession. A rising, and volatile, interest-rate environment has the U.S. equities selling off and entering a bear market where perceived "longer duration" equities have seen their valuations come under pressure.

The geopolitical situation is also reinforcing the uncertainty for U.S. equities. Even as COVID-19 appears to be in the rear-view mirror for the United States, China is still struggling with the continued lockdowns that are a key feature of its zero-COVID policy. Moreover, the prospect of a protracted land war in Europe poses continued challenges for the global economy.

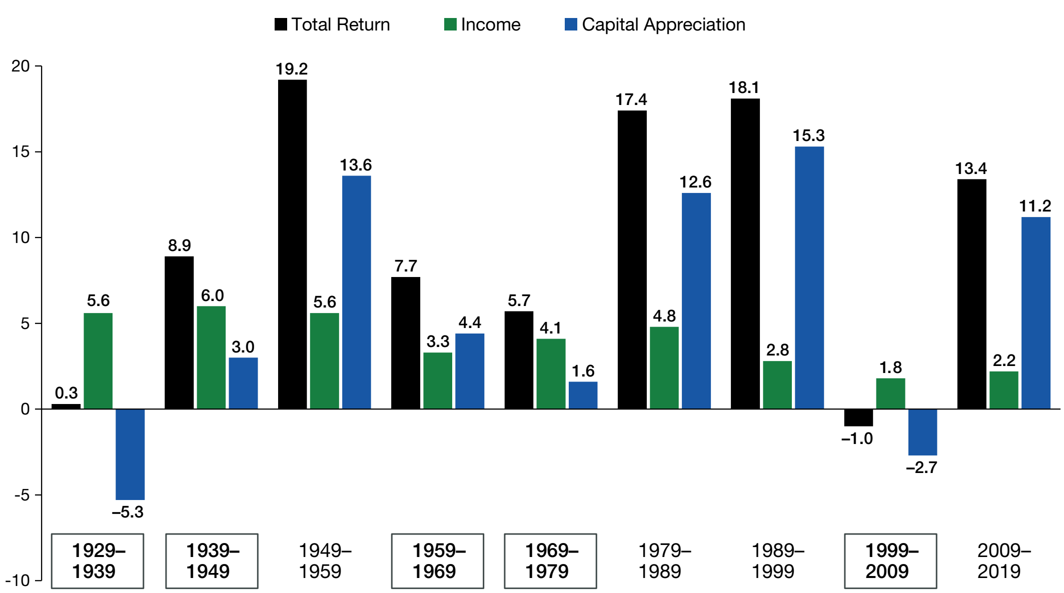
For investors navigating this uncertainty, stocks that historically have paid dividends (dividend payers) and specifically among them, stocks that have consistently grown their dividends (dividend growers) might be a timely option to consider. While in bull markets, investors tend to prioritize capital appreciation and reinvestment of earnings into future growth initiatives. However, in periods of heightened risk aversion, dividends become prized for their potential stability and can be seen as indicative of quality. And the power of dividends over time is evident: according to data from Ned Davis Research, dividends contributed to over 40% of the total return of the S&P 500® Index total return for the period December 31, 1929–May 31, 2022.

The Power of Dividends

The importance of dividends during periods where market returns are below average (less than the long-term average of 10%) is worth noting. (See Figure 2.) During episodes of market volatility, dividends can potentially provide a cushion for investors that can help offset a stock's price depreciation. In each decade where annualized returns were less than 10%, dividends on average contributed to 76% of total return for the S&P 500. This may become increasingly relevant as this decade may not have the same type of return environment as 2010s, particularly as markets adjust to the post-pandemic word.

Figure 2. Dividends' Contribution to Total Return Increases in Range-Bound Markets

Contributions to total return of S&P 500® Index by decade for capital appreciation and dividend income



Source: Bloomberg. Left chart as of 02/28/2022. Right chart as of 04/21/2022. U.S. CPI=Consumer Price Index and Core Consumer Price Index. The U.S. CPI is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. 5Y5Y Forward Inflation Swap is a common measure used by central banks and dealers to gauge the market's future inflation expectations. The historical data shown are for illustrative purposes only and do not represent any specific portfolio managed by Lord Abbett.

Dividend Growers Stand Out

As seen in Figure 1 (first page), shares of companies that have initiated, and steadily grown, dividends have outperformed companies with different dividend policies, including paying but not growing their dividend, cutting, or eliminating the dividend, or not paying a dividend at all. This long-term outperformance is attributable to the typical profile of a dividend grower: a stable business model, a strong balance sheet, a history of capital discipline, and management teams committed to returning value to shareholders. Companies exhibiting both the willingness and ability to persistently grow their dividends have delivered value over a variety of market and economic cycles and through difficult operating environments.

Beyond providing potential ballast for an equity portfolio, dividend growers may also be a timely option amid persistently high inflation. Investors looking to mitigate the risk of pricing power erosion in many industries may wish to consider dividend growers, as a steadily growing dividend has the potential to offset inflationary pressures. Active managers may be particularly well situated across the dividend landscape as they seek to identify those companies that have demonstrated both the ability and the willingness to continue to grow their dividends—and avoid those that have either cut or suspended their dividends or are at risk of doing so.

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

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

The value of investments and any income from them are 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.

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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.

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

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Glossary & Index Definitions

For equities, a **bull market** is a market that is on the rise and where the economy is sound; while a **bear market** exists in an economy that is receding, where most stocks are declining in value, with a 20% pullback widely seen as the determining feature.

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

Equity duration: Stocks thought to have longer durations, i.e., more interest-rate sensitivity, are those whose current prices are more dependent on expected future cash flows rather than current earnings. Thus, these stocks are more susceptible to valuation compression when interest rates rise, based on the notion that higher rates will discount the value of the company's future earnings and thus, its present value.

An **inflation hawk** is a policymaker or advisor who is predominantly concerned with the potential impact of interest rates as they relate to fiscal policy. Hawks are seen as willing to allow interest rates to rise in order to keep inflation under control.

Quantitative tightening, or QT, refers to policies that reduce the size of the U.S. Federal Reserve's balance sheet.

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.

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