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DIVIDENDS: IT'S ALL OVER – OR IS IT?

We are currently living in unprecedented times and I think there is no real historical context in which to make meaningful comparisons, apart from the financial crisis in 2008. However, the challenging market environment we are currently experiencing is different to 2008 – it has been the result of policy responses ("lockdowns"), rather than financial excess. Furthermore, we are in unknown territory and the degree to which restrictions remain in place largely depends on the path of coronavirus infection rates.

As growth and corporate profitability are placed under significant pressure, so too are dividends. Looking at the sustainability of dividends and pursuing a flexible approach in this environment are key factors in pursuing a strategy for regular and growing dividends.

PRESSURE MOUNTS

As we entered the first quarter of 2020, and lockdowns were implemented as a result of COVID-19, the situation placed tremendous pressure on the corporate environment. With the prospect of declining revenues and ongoing uncertainty, we saw that companies began to reduce or suspend dividends. Furthermore, in early April, the Prudential Regulatory Authority in the UK signalled to banks that they needed to preserve capital*, leading some banks to suspend their dividend payments throughout 2020. This followed an announcement in the prior week by the European Central Bank, calling on banks across the Eurozone to refrain from dividend payments and share buybacks until October this year.

Aside from regulatory pressures, in the UK, as lockdowns became extended, we could see that this was creating a challenge for those companies that had high levels of debt or did not have the flexibility to accommodate the external environment. It came as no surprise, therefore, to learn that by the end of the first quarter, 45% of UK companies had already stopped dividend payouts to shareholders, representing cuts of £28.2bn**.

However, understanding the full picture is important. Our UK equities team highlights that some companies were already facing challenges going into 2020 and the COVID-19 crisis simply amplified difficulties regarding dividends. The recent dividend cut by BP is a good example. This move is not specifically COVID-19 related, more a result of structural challenges that have been building for years. We are also seeing similar moves in companies within sectors such as retail and retail real estate. These companies need to evolve their business and financial models to establish a new sustainable future before meaningful dividends can be resumed.

UK DIVIDENDS: ALL CHANGE

The furlough scheme and Bank of England emergency lending has made it easier for companies to preserve cash. Even more

***Source: Bankofengland.co.uk, 31/3/2020**
****Source: Link Asset Services, UK Dividend Monitor, Q1 2020**

importantly, the expected downturn is not as bad as expected and the recovery in activity levels is swifter than many had anticipated.

Our UK equities team believes that the direction of travel for UK dividends is swinging back to reinstatement. They highlight that for many UK businesses, recent trading statements are confirming that financial performance and the current outlook are comfortably at the top end of planning ranges. This has led many businesses to commence repayment of government support; a sensible prerequisite for the resumption of dividend declarations. Taylor Wimpey, the UK housebuilder and previously a large dividend payer, recently announced that all employees have returned to work, all furlough subsidies have been returned to the Government and that the board expect to pay the final dividend in 2020 and possibly resume the special dividend program in 2021. This is a remarkable demonstration of resilience in an industry that saw cashflows hit especially severely during lockdown. The UK team believes this example is a good proxy for much of UK plc.***

On a final note, there are many companies in the UK that have low leverage and a level of resilience that gives them flexibility to navigate this changing environment – they'll continue to be sustainable dividend payers. In many instances, this success is not the result of short-term actions, but a sustained focus on building a resilient business for which management teams deserve considerable credit.

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WHERE IS THERE VALUE OUTSIDE OF THE UK?

Our global equities team believes that dividends in North America are likely to be less adversely affected than other western markets. Share buybacks have historically been a dominant factor in shareholder distributions in the US and, in contrast to Europe, companies have so far shown more of a tendency to cut buybacks than dividends.

The US market also has a favourable sector mix for the current environment, with many technology companies relatively unaffected by or even benefiting from the pandemic, due to increased demand for their services. As an example of companies doing well, the first quarter dividend from Microsoft was $350m higher than a year earlier, putting it on track to become the world's largest dividend payer this year. The defensive healthcare and consumer staples sectors were also material contributors.

What is also apparent in the US is that dividend paying companies and, in particular, well managed companies that can grow their dividend consistently, generate superior stock market returns over non-payers and those that do not grow or cut their dividends. In addition, these returns were delivered with a lower risk profile than the market, as the table below indicates. These differences can compound very substantially for investors over long periods of time.

*****Taylor Wimpey, half year results, 29 July 2020**

AVERAGE ANNUAL RETURNS AND VOLATILITY BY DIVIDEND POLICY
(3/31/72–12/31/19)

	Returns	Beta	Standard Deviation
Dividend Growers & Initiators	12.87%	0.92	15.61%
Dividend Payers	12.79%	0.98	16.36%
No Change in Dividend Policy	11.85%	1.13	17.92%
Dividend Non-Payers	8.57%	1.13	24.33%
Dividend Cutters & Eliminators	10.88%	1.23	24.08%
Equal-Weighted S&P 500 Index	12.29%	1.00	16.98%

Data Sources: Ned Davis Research and Hartford Funds, Feb 2020 Dividend Policies are shown for stocks in the S&P 500.

Another example of dividend leadership in the US is reflected in the "Dividend Aristocrats". This is a group of 65 S&P 500 stocks with 25+ years of consecutive dividend increases that meet certain minimum size and liquidity requirements.

They are the 'best of the best' dividend growth stocks and have a long history of outperforming the market. Examples of stocks in this select group include Colgate Palmolive and Proctor & Gamble, companies that we own in our Sustainable Global High Dividend strategy.

Elsewhere, dividend yields in Australia, Hong Kong, Singapore and in some Emerging Markets are among the highest in the world. For example, the chart below shows that Asia-Pacific has an attractive free cash-flow yield, a ratio that measures the cash a company generates to meet debt, dividend and other obligations, suggesting these companies have sufficient reserves to cater for yield-seeking investors. One strongly held view is that Asian companies pose less dividend risk, have more robust finances and appear better equipped to pay stable dividends compared with their western counterparts, which are constrained by highly levered balance-sheets and the need to preserve cash. Asia appears to have much more insulation in terms of sustainability of cash outflow items such as capital expenditure.

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APPLYING OUR HIGH ACTIVE, CONVICTION

The Global Equities team has actively positioned the Sustainable Global High Dividend strategy towards the US, where it currently has a 68.3% weighting (versus 60.7% for the MSCI AC World Index) because of the more favourable environment for sustainable dividends.

Source: Mirabaud Asset Management, 31 July 2020

GLOBAL EQUITY INCOME: QUALITY REALLY MATTERS

The challenges raised by COVID-19 underscore the importance of focusing on companies with both high free cash flow yields and strong balance sheets. The global equities team believes that quality really matters in their environment and this is reflected in the way they seek opportunities in the Sustainable Global High Dividend strategy.

They select companies that have an investment grade rating assigned to their debt, with low levels of borrowing and plenty of cash, making them more flexible to navigate difficult conditions.

However, this is only one piece of the jigsaw when pursuing sustained and growing dividends.

Themes play another role because they provide an important tailwind for companies. Our Global Equities team have been investing thematically for over 17 years and they've honed their approach to maximise both growth and dividend opportunities, whilst keeping a close eye on diversification and risk. They have identified eight broad global themes that position companies to take advantage of transformative, long-term trends and these include multiple sub-themes underneath them. Their interconnectivity is innovation and business disruption and companies that the team identifies within these themes have the potential for topline growth – this is key to generating sustainable, strong cash flow and dividend yield.

To further illustrate this point, themes are coming into their own in this period of market uncertainty. The team's Explosion of Data theme is a good example, which reflects a move towards the digital economy and the changing preferences in the way individuals access information. As many countries around the globe faced a lockdown as a result of the coronavirus, the 'stay at home' economy strengthened significantly as companies switched to remote working. This led to strong increases in demand for data and internet traffic, providing strong tailwinds for companies in this area.

The Global Equity team's approach to quality and themes is then augmented by selecting companies with stronger ESG credentials. This is the final piece in the 'quality' jigsaw. We believe that companies actively managing their Environmental, Social and Governance factors are better placed to manage long-term risks, which is critical to maintaining and growing their dividends.

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ALWAYS FOCUS ON QUALITY

Both the UK and Global Equity teams believe that quality remains paramount – companies with strong finances that generate lots of cash are best placed to pay dividends. It's important to maintain a high 'quality' ethos at all times.

Despite all the challenging news, which has been linked to price falls, this actually creates opportunities for new investors. In summary, where an expectation of secure dividends is identified, lower prices means a higher prospective yield for new investors, and should benefit them when the manager follows well-defined disciplines and has access to a reliable set of dividend paying investment opportunities.

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