Perspectives

THE DIVIDEND GROWTH STRATEGY: MAINTAINING AND GROWING INCOME IN RECESSIONS

The Dividend Growth strategy is a high-quality equity portfolio. As the firm's flagship portfolio, it represents a pure implementation of the company investment philosophy. This philosophy is based on over 50 years of implementation and is grounded in the belief that more consistent, predictable companies can be effectively identified by their dividend history. Combining a high-quality orientation with a perspective that the investment environment is uncertain and constantly changing leads us to believe that protecting capital during adverse market conditions is a highly effective way to add value. At the same time, quality companies with consistent businesses tend to offer above-average visibility on achievement of fundamental progress and empower upside participation when markets are good. The compounding effects of dividends and earnings growth, combined with mitigated risk, can lead to long-term outperformance over a full market cycle. Dividends hold additional appeal by providing current income to finance client withdrawal needs through both negative and positive equity return periods while preserving invested capital and reducing the disruptive negative impact of drawdowns.

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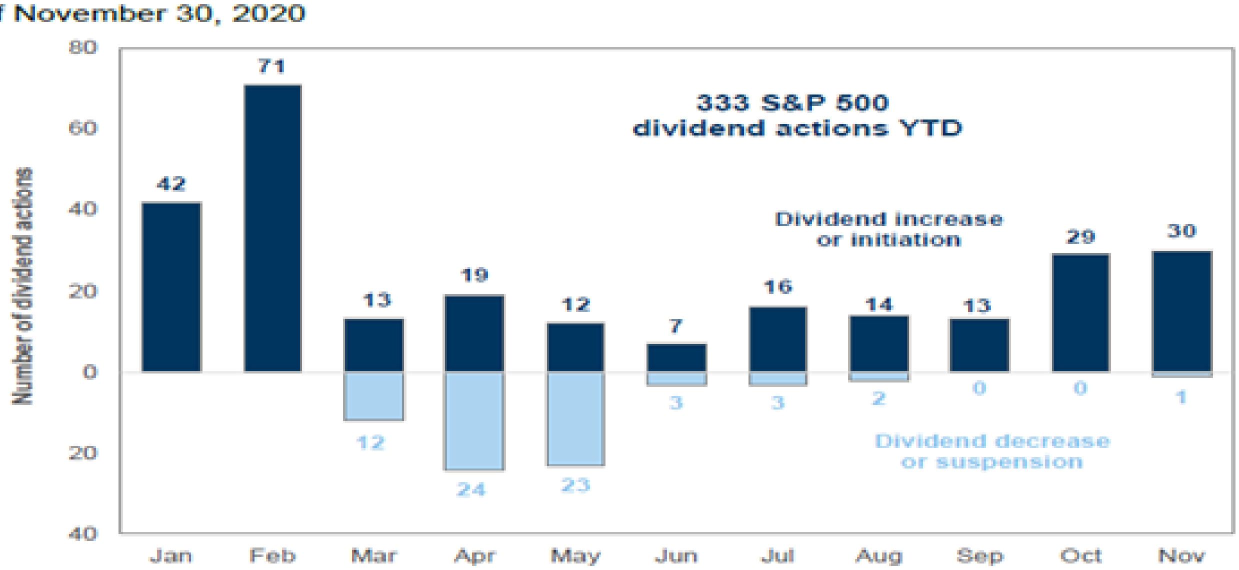
The process begins with a structurally advantaged universe from a quality standpoint. This enhanced opportunity set is based on companies with a consistent dividend payment history, and the universe is further refined and improved upon by extensive fundamental research conducted by our highly experienced analyst team. The end result is a diversified yet focused portfolio of 35 to 40 of our best ideas. The higher certainty and predictability of the companies within the portfolio, combined with valuation sensitivity, help narrow the range of potential outcomes and afford clients a smoother ride with less volatility.

This year has been one of extreme volatility on several fronts. Yet, we have been encouraged by the commitment to dividends clearly demonstrated by portfolio company leaderships. In 2020, the Dividend Growth strategy experienced no cuts or omissions, and the average holding is paying a higher dividend than last year, which is largely consistent with our experience in other periods of financial stress. In fact, our portfolio has only encountered dividend reductions twice over the past dozen years despite two deep recessions. The dividend integrity displayed by our portfolio companies contrasts to what's taking place broadly in this destabilized financial environment, as nearly 70 S&P 500 companies have reduced or suspended dividend payments just since March, and we fear there may be more to come.

Exhibit 1: S&P 500 dividend cuts have moderated, increases have accelerated
as of November 30, 2020



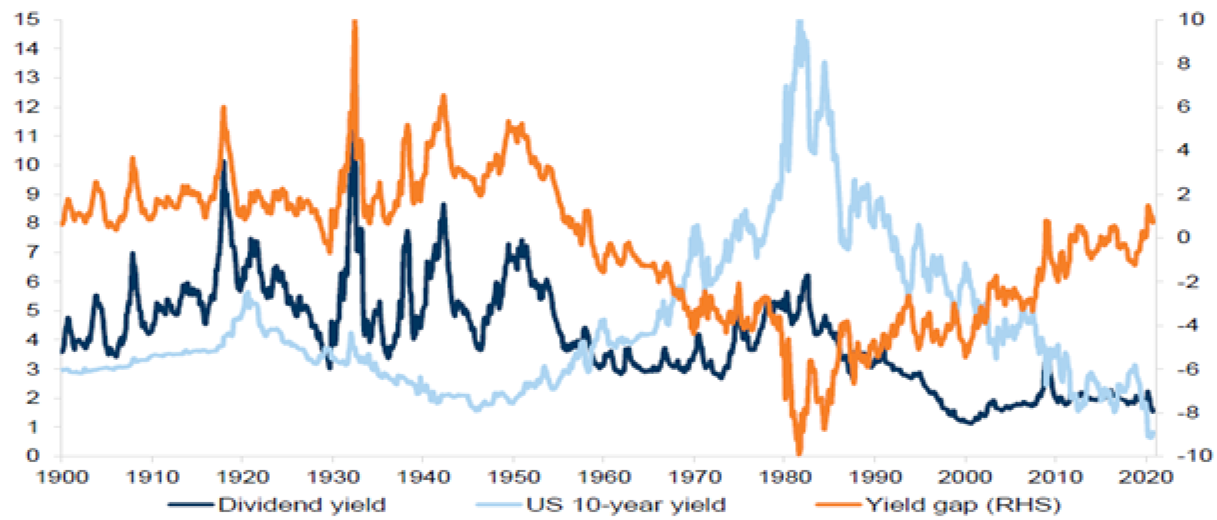
Source: Standard and Poor's, Goldman Sachs Global Investment Research

The Dividend Growth Strategy: Maintaining and Growing Income in Recessions

Each investment and economic cycle is different, and the recent downturn was both swift and severe. One differentiating feature as it relates to dividend policy was the large number of companies that suspended or omitted dividend payments. In prior cycles, the tendency was for corporations to reduce dividend payouts in periods of economic or company-specific stress, but this time, we saw more companies elect to pay no dividends at all. It remains to be seen how many of these companies will reinstate their dividends.

With equity dividend yields now exceeding bond yields by the widest margin in a half century (and the Dividend Growth strategy dividend yield exceeding that of the S&P 500 by 50%), the opportunity for relative income generation through equity ownership is at multi-decade highs for those investors who own stocks of companies that have been able to maintain their payouts.

Exhibit 21: The gap between dividend yields and bond yields is close to levels from the 1950s again
Data for S&P 500



Source: Robert Shiller, Goldman Sachs Global Investment Research

We believe the Dividend Growth strategy's relative preservation of current income for clients reflects one key aspect of our fundamental research. Through our commitment to the implementation framework and quality emphasis, we have been able to avoid owning companies that do not have the propensity to maintain and grow dividends through inevitably recurring adverse economic periods.

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