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The Underrated Part of Investing in Equities: Dividends

By Pat Kilbane, J.D., CDFA

During the first two quarters of this new decade, we have seen wild and dramatic fluctuations in stock prices. We have witnessed equity markets make a month or even two months' worth of moves in a single day! Despite the recent, immense swings in equity prices, the resilient feature of investing in equities (or as Glenn calls them, "the great companies of the world") is the dividend you as a shareholder receive for owning a share of stock in a dividend paying company.

What is a dividend? Investopedia defines a dividend as "The distribution of a portion of the company's earnings, decided and managed by the company's board of directors, and paid to a class of its shareholders." Companies usually pay dividends on a quarterly basis. Do all companies pay dividends to their shareholders? No, they are not required to do so, but many (approximately 85% of companies listed in the S&P 500 as of late 2019[1]) choose to pay a dividend as an incentive to continue to attract investment or increase its value. Typically, companies that choose not to pay a dividend do so because they want to invest those funds in future growth.

For purposes of this report, I will refer to the dividend that a company pays as the income portion of the stock market. Odds are many investors tremendously underestimate just how significant dividends are over the course of an investor's life. According to a study by Hartford Funds, dividends have played a significant role in the returns investors have received during the past 50 years. Going back to 1970, 78% of the total return of the S&P 500 Index can be attributed to reinvested dividends and the power of compounding[2].

The income portion of an equity investment is especially important during down markets. Even though the market price of the equity may be experiencing a temporary decline in value (and assuming the board of directors has not decided to reduce or eliminate the dividend), you as an investor will still receive the income portion of your equity investment on a quarterly basis.

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[1] Strauss, Lawrence C. "78 Stocks in the S&P 500 Don't Pay a Dividend. Here Are Some That Should." *Barron's*, 9 Nov. 2019, www.barrons.com/articles/78-stocks-in-the-s-p-500-dont-pay-a-dividend-here-are-some-that-should-51573233301, Accessed 18 June 2020

[2] Hartford Funds. "The Power of Dividends: Past, Present and Future." *Hartford Funds.com*, 2020 Insight, https://www.hartfordfunds.com/dam/en/docs/pub/whitepapers/WP106.pdf, Accessed 18 June 2020.

Unless the investor needs the income to fund their monthly living expenses, these dividends should be re-invested. This will enable the investor to acquire more shares at a lower price (during down markets). Of course, dividends are still paid (and may even be increased!) during a company's more prosperous times. And those dividends should also be re-invested.

How do dividends hold up during a recession? Dividends are remarkably strong during challenging economic times. Amazingly, during the Great Depression when the stock market temporarily declined by more than 80%, dividends were not even reduced by 50%. For a more recent example, during the financial crisis of 2008-2009, dividends for S&P 500 companies were cut by less than 25%. This is remarkable!

One final key point about dividends is their growth rate versus inflation. During the last century, dividends grew at approximately 5% per year. During this same period, the average annual rate of inflation was approximately 3% per year. Where else will an investor be able to find a source of income that will outpace inflation by an average of 2% per year?

During times when there is temporary downward volatility in equity markets, some clients will inquire about seeking safety in purchasing gold, guns, or even increasing the fixed income portions of their portfolios. However, gold and guns pay zero dividends and they never will. As of June 9, 2020, the 30-year treasury yield is 1.68%. Taking all of this into consideration, investors should relish the opportunity to "own the great companies of the world" that also pay them a stream of income to own their shares.

For investors who have a longer horizon and have the appetite for more volatility, it is hard to argue there is a safer haven during down markets than equities. In a future report, we will discuss the fixed income component of our portfolios and why it is an essential part of our investment philosophy and wealth management process. Proper diversification in our clients' portfolios includes exposure to both dividend paying and non-dividend paying stocks, as well as bonds, so that our clients can reach their goals.

Pat Kilbane is the Director of Divorce Advisory Group, an affiliate of Ullmann Wealth Partners, and is also a Wealth Advisor. Prior to joining the firm, Pat practiced family and matrimonial law for nearly a decade. He had previously worked as a Shareholder for the Florida statewide law firms Gray Robinson, P.A. and Rogers Towers, P.A.

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