WASHINGTON CROSSING ADVISORS 26 OCT 2021

CORNERSTONE COMMENTARY

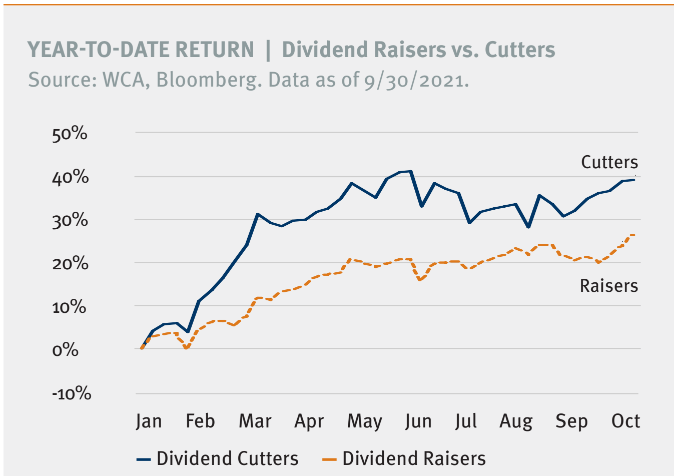
PUTTING DIVIDEND GROWTH TO THE TEST

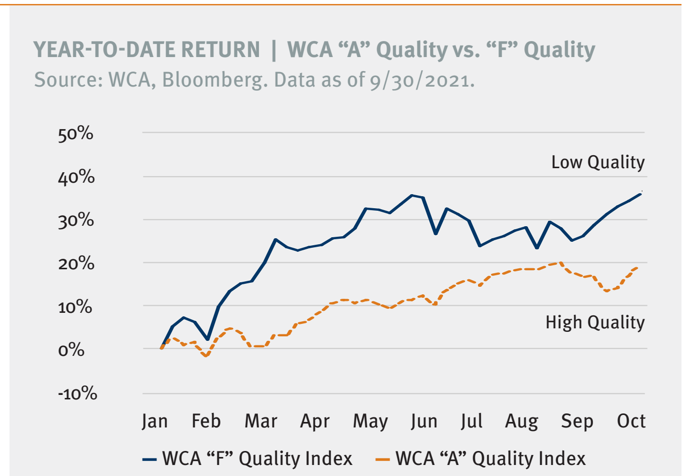
The “Case for Rising Dividends” rests on a crucial proposition: that dividend growth tends to point to quality. In this brief, we wish to put this proposition to the test using evidence from the COVID-19 pandemic. We will rely on two sets of data: portfolios created based on dividend behavior in the aftermath of the pandemic and our WCA Quality “Grades” from the onset of the pandemic. Those “grades” are based on a company’s predictability, indebtedness, and profitability. The question we ask is whether dividend behavior and quality are, indeed, related?

The Evidence

Year-to-date, we see stocks of companies that cut dividends last year rising faster than those which increased the dividend (Chart A, below-left). At the same time, we see low-quality company stocks also running ahead of high quality (Chart A, below-right). While quality dividend growers are lagging this year, the key takeaway should be that the right and left graphs below look very similar. This suggests that dividend behavior (left graph) and quality (right graph) are clearly related.

Chart A. Dividend Behavior (Left) or Quality (Right): Performance is Similar ***Year-to-Date 2021 through October***



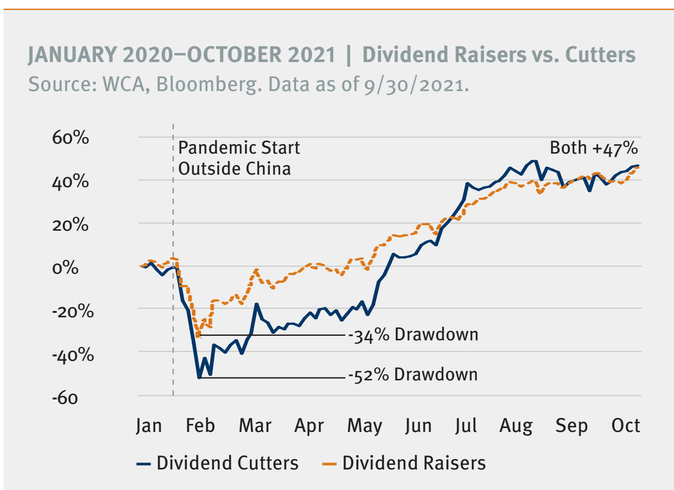


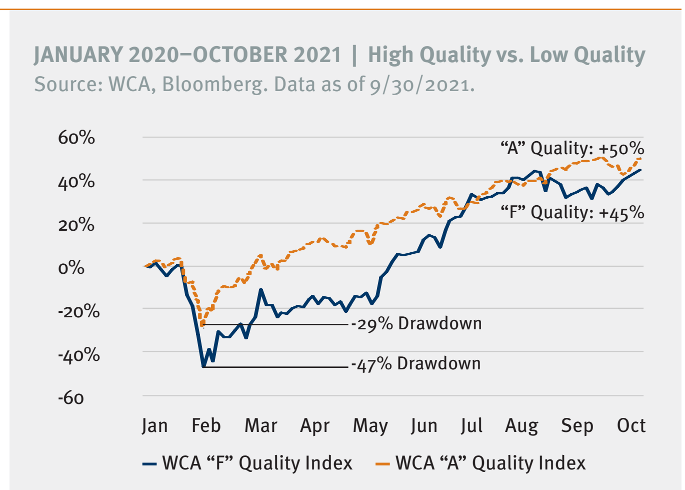
More Evidence

We also see a clear relationship over the pandemic period from January 2020 through October 2021 (Chart B, below). As the pandemic set in, nearly all stocks fell. The "A" Quality companies and those who would go on to raise dividends in 2020 fell 29% and 34%, respectively. Yet the "F" Quality companies and dividend cutters fell a massive 47% and 52%, respectively.

Those drops were followed by improvement. Today, the return for all categories of stocks since early 2020 is about 50%. Once again, the critical insight is that the left graph (based on dividend behavior) looks much like the right graph (based on quality). The pandemic era confirms the proposition: that dividend growth tends to point to quality.

Chart B. Dividend Behavior (Left) or Quality (Right): Performance is Similar ***January 2020 – October 2021***





Deeper Dive

We also looked at the 1,000 largest U.S. companies at the start of 2020 and asked, "Which companies cut or raised dividends during the year?" Our analysis showed 448 increased dividends, 100 cut, and 452 had no change. We then asked what the composition of the growers and cutters looked like based on our WCA Quality "Grade." Chart C below shows that the growers tended to be of much higher fundamental "quality" than cutters, which tended to be low "quality." It should be noted that we determined quality before the start of the pandemic to avoid biasing the result. This result further validates the idea that dividend growth tends to point to quality.

Worth the Risk

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Conclusion

The pandemic era allows us to test a crucial proposition: that dividend growth points to quality. The evidence and facts of the past 22 months support this proposition. Combining a longer view of dividend growth and quality with the "stress test" of the pandemic provides robust evidence that a long-term investment strategy focused on fundamental quality is a sound way to build wealth and grow income over time.

Chart C. Dividend Increasers Tend to be High Quality, Low Quality Tend to Cut

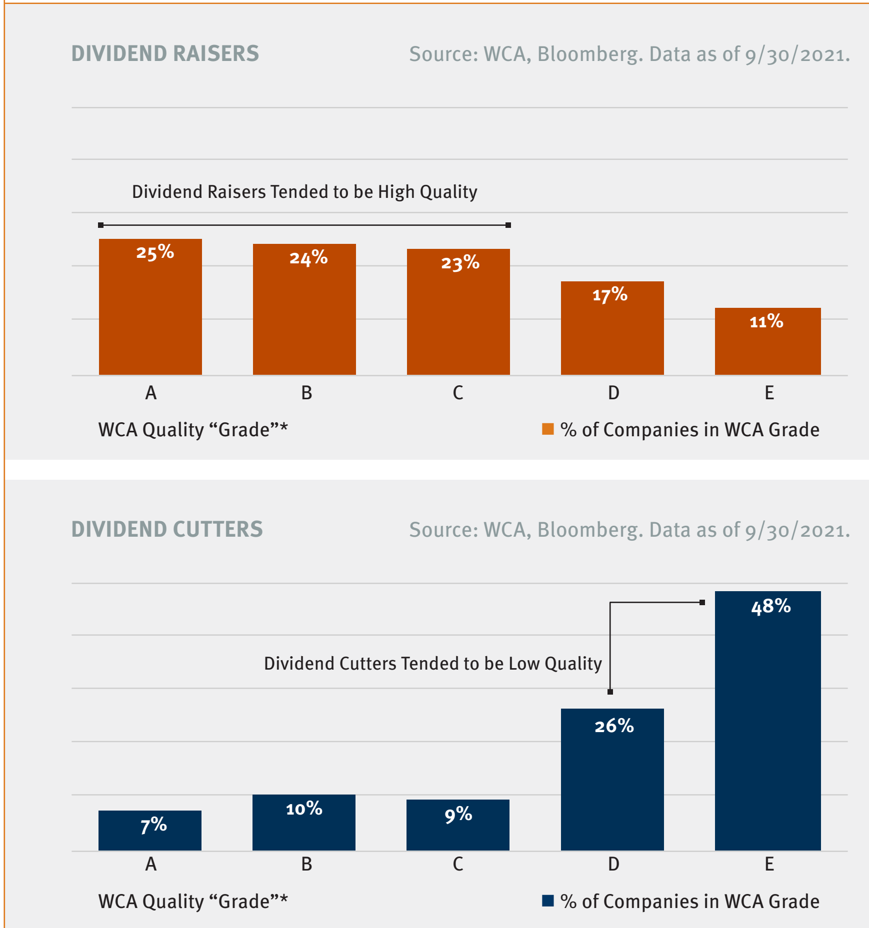
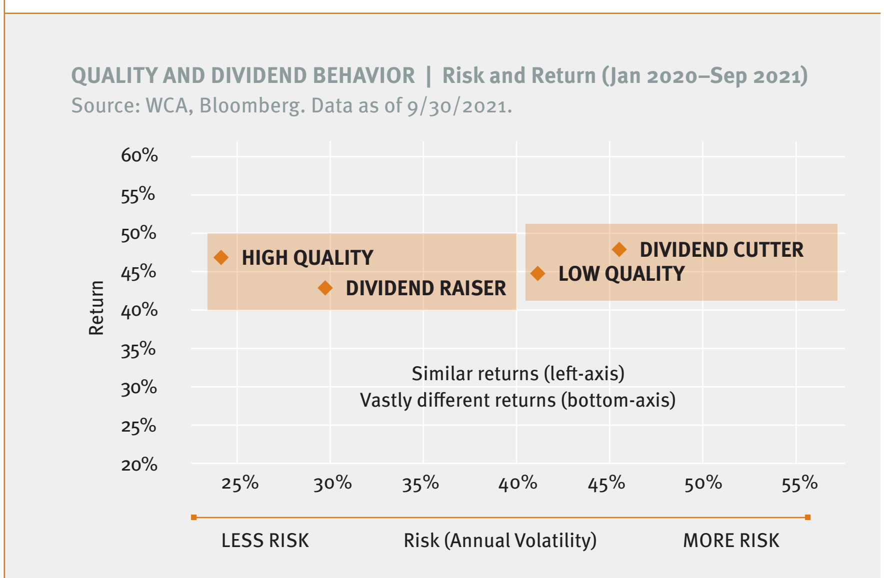


Chart D. Returns Similar, But Risk is Very Different



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** Note: Universe of companies based on the 1,000 largest U.S. companies at the start of 2019. There were 448 Dividend Raisers and 100 Dividend Cutters during 2020. The WCA Quality "Grade" assesses fundamental quality based on our proprietary model focused on earnings consistency, profitability, and degree of leverage. The grades were assigned as of 12/31/2019 to avoid look-ahead bias.*

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