"Follow up questions to the Belshazzar's Feast paper"

Q. How does the Dundas approach tackle the issues raised in the paper?

A. We will continue to focus upon dividend security and growth to avoid dividend cutters and find stocks which will produce sustained dividend growth. Our paper cited studies by London Business School that demonstrate the centrality of dividends to Long run equity return. Long term investors must take seriously dividend growth.

Q. So how difficult is it going to be to find suitable companies to invest in?

A. The twin risks of rate rises and deflation changes the game but there are good companies you can invest in which deliver dividend growth. Finding them requires a fresh approach, thorough research and excellent tools.

Q. If the traditional sectors are no longer the drivers for dividends which ones are taking their place?

A. If we're right and the five sectors highlighted in our paper suffer lower profits and / or experience rising internal investment demand, then they'll become a drag on global dividend growth. That's our concern. As for 'taking their place', there are a number of companies able to produce sustained dividend growth which we like. A number of them are in the technology sector, historically not a place investors first thought of as a source of dividends, but many companies generate lots of cash, have low reinvestment requirements and are committed to rising dividends – Microsoft for example. Another is General Electric, now with the disposal of its banking business behind it and ready to generate cash and growth for the medium term future.

Q. Should investors revise down their expectation for dividends – do you have a feel for the new normal?

A. The question drives us back to the distinction between dividend and yield. If you're holding a portfolio dominated by the sectors we highlighted in the expectation of steady dividend growth we would suggest that you research them swiftly and thoroughly to be sure of the prospects. The yield on these stocks will fluctuate with their share prices and, as you can infer, we are cautious on their prospects.

As for expectations, the same London Business School study cited in the report indicates that post WWII global dividend growth has been c.2% p.a. with fluctuations as inflation has ebbed and flowed. To quote the 2016 GIRY (page 33)

'It would be a delusion to anticipate the same level of dividend income as in the past, coupled with indefinite real growth in dividends at the post-1950 level of more than 2% per year'

That tells us – borne out by our own research – that it is vital to invest for secure, sustainable dividends and dividend growth. Right now, we see good prospects for continued above-inflation dividend growth from the portfolio in which we are invested. But things are getting tougher, not easier…

Q. Given the impact of the compounding effect on total return should we also expect lower total returns or will companies go through a repair period and generate greater capital returns over time?

A. Forecasting future equity returns is a 'stick your neck out' challenge, but here goes. Using the LBS data, real global equity total returns since 1980 have been 6.5% per annum, using US CPI as the inflation rate. Much of that gain has rested upon strong capital gains. If we accept that the once-in-a-multi-generation effect of the 35 year decline in interest rates / bond bull market is behind us, then one of the factors supporting these strong returns is much diminished. That's a roundabout way of saying we should be cautious. Dividend risk from the sectors we highlighted is part of the equation but not all of it.

What can be said is that the 5.9% per annum total return from global bonds from 1980 to 2015 cited by LBS is not going to be repeated between now and 2050. Investing in bonds at today's yield in the expectation that the past will define the future is not valid.

Q. How have you been going since Dundas commenced operation?

A. Over the last three and a half years our portfolio's dividend growth has been consistently much higher than the equivalent figure from the index. We've had one stock reduce its dividend in that whole time. Our relative performance has struggled to match the index due to falling US yields/a bull US market which have made keeping up on the capital side a struggle. However about nine months ago those adverse forces started to ebb and relative results have improved.

Our approach provides the security of a dividend stream from a high quality global portfolio, capable of sustained growth ahead of inflation.

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