DUNDAS GLOBAL INVESTORS

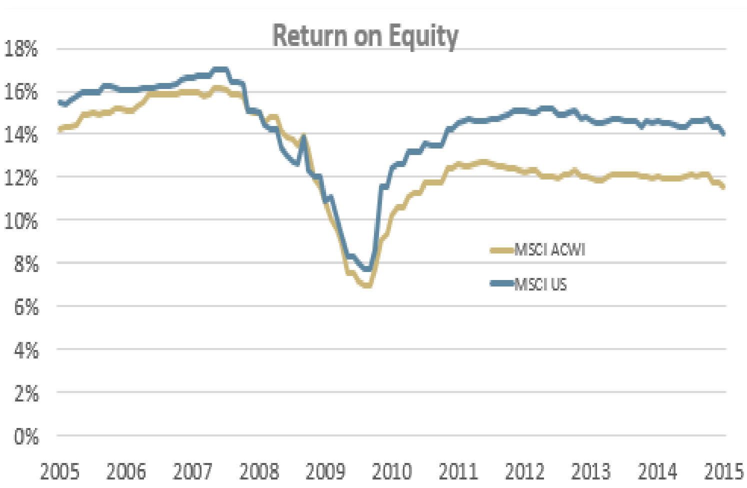
Dividend dashboard

August 2015

Every month, MSCI releases another batch of data on its various world and country indices. Given our focus on earnings growth, profitability and dividends, we scour them to see what useful information on corporate health we can glean from a Dundas perspective.

Summary

Dividend growth has been strong in the past three years and particularly in the US, which has helped to underpin rising equity market levels. However, much of this increase has come about from the one time benefit of rising payout ratios against a background of weak profits growth. Unless profitability improves, dividend growth rates for the market overall will continue to fade, dragged down by the Telecommunications, Financials, Materials and Energy sectors.



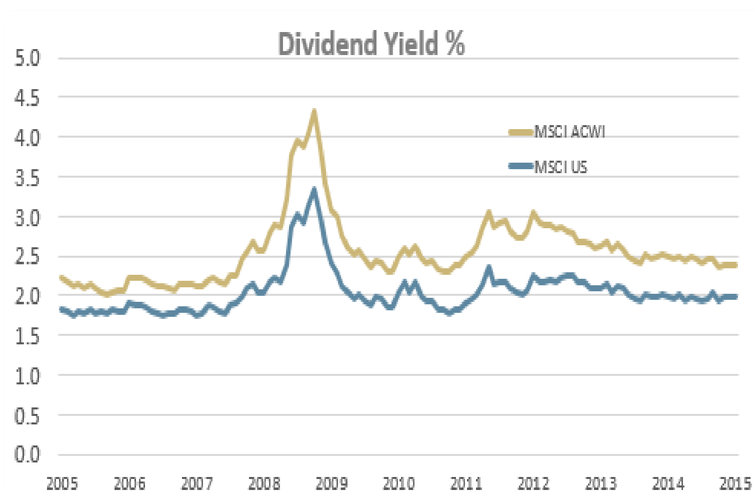
Profitability

After a sharp recovery following the financial crisis, returns on equity have flat-lined in the US and in ACWI as a whole. The US has been around 2% higher during this period at 14% but still below the 17% reached in 2007. ACWI is now back at its long term average of 12%, implying that the world excluding the US is around 10%. Both are well below the recent highs of 2007. Given the amount of equity that has been "retired" over those years through stock repurchases, it is surprising that returns are not higher.

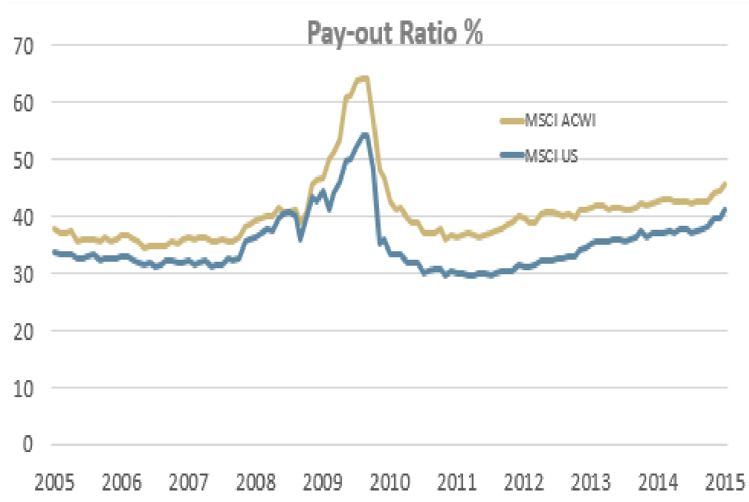
Valuation

Dividend yields are virtually unchanged for both ACWI and the US in the last five years at around 2.5% and 2.0% respectively. At the 2011 lows, they reached 3.0% and 2.3%. During this period, bond yields around the world have continued to fall as the QE baton has been passed from the US to Japan and Europe.

Taking a five year view with dividend yields broadly unchanged and markets up, we can infer that dividend growth has risen with market levels. More recently, the yield on the US market has been pretty constant, while ACWI has seen a modest fall.



Dividend pay-out trends

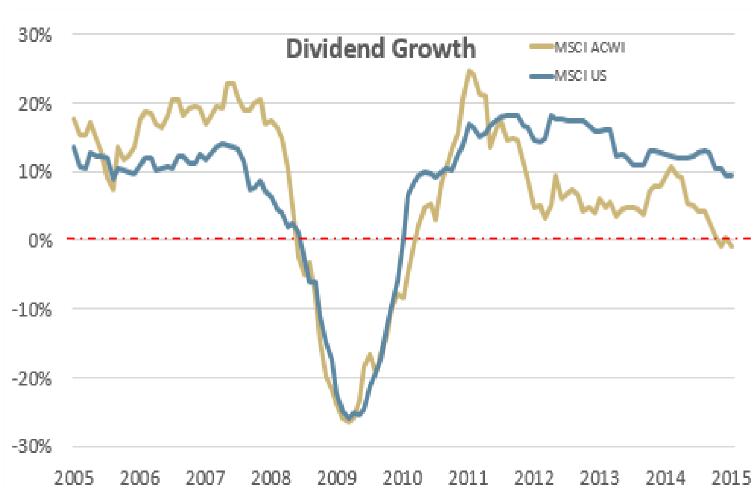


The story so far would suggest weak profitability growth but stronger dividend growth, implying that companies must be paying out more of their profits in dividends. This chart shows this pay-out ratio and demonstrates the steady rise in pay-outs for ACWI and even more so for US companies.

That ratio is now approaching 45% for ACWI and 40% for the US. Since 2010, US companies have increased their payout ratio from around 30% to 40%, accounting for a very significant proportion of dividend growth over that period. Looking back more than ten years, both ACWI and the US are at or above longer term averages.

Dividend growth rates

Let's start with some long term context. Studies have shown that over many decades, dividend growth rates have averaged around 6.5%. While dividends are a very stable form of return – particularly next to the very volatile nature of capital returns due largely to valuation changes – they do have cycles! In the up years, dividend rises of high single digits and sometimes more are followed by generally short periods of 12 to 24 months of contraction.



Excluding the 2011 recovery, dividend growth in the US in recent years has been just above 10% while for ACWI the average has been closer to 6%. The charts show that both have tailed off during the past four quarters. One impact has been the stronger dollar used as the base currency for this data. Non dollar dividends have suffered a currency translation effect, while global US corporations are seeing a similar impact on their profits. The biggest culprits in this slowdown have been the Telecommunications, Materials, Energy and Financial sectors. Dundas has struggled to find good growth companies in each of these sectors.

Valuation versus sustainable growth

The next move in interest rates will be up so we might expect little by way of valuation expansion and more emphasis on earnings and dividend growth - our portfolios are well placed for that transition. In the 12 months to June 2015, Dundas portfolios' dividend growth has continued to beat the Index, up 5.9% in USD terms against -2.2% for the MSCI ACWI.

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