An investor guide to dividends

Aberdeen Standard Investments

We explain what dividends are and why investors might want to hold them.

By Ben Sheehan, Senior Investment Specialist, Equities, Asia Pacific

What are dividends?
Companies listed on public stock exchanges issue dividend payments to shareholders as a means of returning their profits directly to them. Some firms pay dividends regularly in the ordinary course of business, mostly semi-annually or annually. Sometimes companies also issue special dividends to shareholders – typically larger, one-off payments as a result of a windfall such as the sale of an asset.

Why do companies issue dividends?
When a company pays a dividend it tends to increase investor interest in its stock. This can help to raise the share price and unlock value in that company. In general, paying dividends demonstrates good capital management and respect for shareholders. It also incentivises investors to stay invested and so helps to encourage a stable, loyal shareholder base – which is also supportive of share price.

What is good capital management?
Businesses that make profits and reinvest back into the company and/or return at least some of this capital to shareholders demonstrate sound financial discipline. What investors don't want to see is companies retain excess cash on their balance sheet without good reason. Paying dividends is often seen as an indicator of good corporate governance. It is not the only factor, but it is one of them.

Should investors associate paying dividends with company quality?
Paying dividends can serve as an indicator of company quality. However, it's not always the case. For example, a company might be offering a high dividend yield – which is the dividend it pays calculated as a percentage of its share price. However, that may be due to a fall in share price, which could point to its waning business prospects and highlight how its dividend is not sustainable. It is key for investors to understand a company's fundamental strengths and therefore its ability to sustain its earnings and maintain its dividend payments.

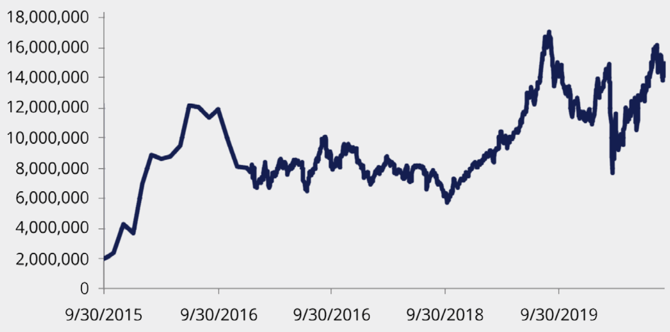
Do all companies issue dividends?
No. Companies at an earlier stage of development tend to reinvest their profits into new business expansion. In other words, they retain their earnings to fund their future growth. Many fast-growing companies remain popular with investors even though they pay low or no dividends – such as tech stocks – because they generate good rates of return. But companies at a more mature stage of development don't need to reinvest in their business to the same extent. As such, they may combine re-investing for the future with sustaining shareholder loyalty by paying out dividends.

Can companies continue to pay dividends in this challenging environment?
Despite numerous companies delaying or cutting their dividends to ensure a sufficient capital buffer to counter the impact of the coronavirus pandemic, there remains a large, global universe of stocks that continue to pay out dividends. The pandemic has affected industries and sectors differently. Some are better placed or able to adapt than others. The dividends of companies operating in sectors such as technology, health care, consumer staples and materials have proved more resilient during this Covid-19 chapter than banks, insurers, automakers and property developers. We analyse thousands of companies and have drawn up a buy-list of more than 1,100 stocks. We can see the companies best able to sustain their earnings and/or that have sufficient reserves to maintain dividend payouts. Despite a challenging market environment, there remains ample opportunity for investors to find companies able to continue paying dividends.

Do you expect continued investor interest in dividends?

Yes. Monetary and fiscal support for markets following the 2008 financial crisis and 2020 global health pandemic have driven interest rates to record lows and exacerbated a search for yield. A staggering US$15 trillion worth of bonds offer negative yields today (see chart below), forcing investors to buy riskier bonds to attain sufficient yield or consider looking elsewhere. Equity is one of the few asset classes where investors can still find attractive yields. It can also act as a good diversifier for investors who remain heavily reliant on bonds for income. In addition, the global demographic shift of ageing societies equates to more people seeking income to fund their retirements. In Asia especially we have seen strong demand for income funds, and we expect this trend to continue.

Bloomberg Barclays Global Aggregate Negative Yielding Debt (US$)

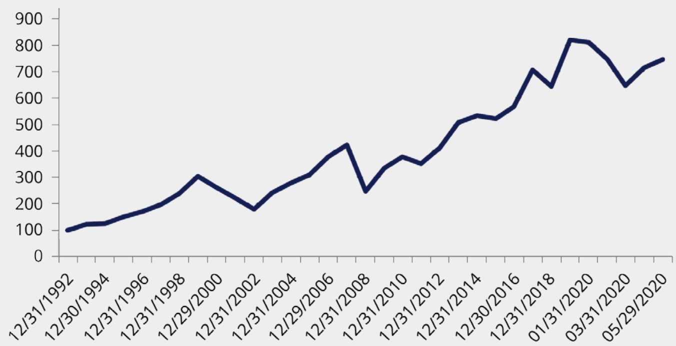


Source: Bloomberg, USD terms , 2 September 2020. For illustrative purposes only. No assumptions regarding future performance should be made. Past performance is not a guide to future results

But aren't equities also volatile and risky?

Yes, equity can be a volatile asset class. However, history shows that returns have compensated investors for taking on equity risk (see chart below). When markets turn volatile, dividend-paying stocks offer investors an income as they wait for the markets to recover. One key factor is that dividend-paying stocks offer opportunities to capture both yield and capital growth. It's why we believe that a disciplined approach to managing a global equity portfolio will offer attractive risk-adjusted returns over the long term.

MSCI AC World Total Return



Source: Bloomberg, MSCI, June 2020, rebased to 100.For illustrative purposes only. No assumptions regarding future performance should be made. Past performance is not a guide to future results.

AberdeenStandard Investments