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# Are dividend shares “in” or “out”?

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Among the best-known rights of a shareholder are the right to participate at the Annual General Meeting (AGM), the right to vote, and the right to a dividend. But who really attends an AGM?

Shareholders have seen great rates of return in recent years. Short set-backs were often used as opportunity to invest along the lines of “buying the dip”. In the USA, a new generation of investors has emerged, the Robin Hoods – named after the online broker Robin Hood, where shares can be bought at low (or sometimes no) fees.

These largely young and sometimes inexperienced investors have so far only ever seen rising markets. And how do you ideally navigate a rising market? – By buying everything that sounds good, regardless of the quality of the company and its products. In fact, the more speculative the business model, the higher the potential gains. If only it were that simple! Some of us remember the years 2001 to 2003 and 2008, when the global equity markets lost about 50% from their peaks to their lows; and, in contrast to the status quo: the more speculative the company, the bigger the losses. Having companies that pay dividends in one’s portfolio pays off in difficult years.

## Value or Growth – what was hip?

The shares of companies with a good business model, well-known brands, a solid balance sheet, and attractive dividends are often referred to as *Value* shares. By contrast, the shares of companies that post high growth especially of sales and that are expected to turn profitable in the future are called *Growth* shares. Which of the two categories has fared better in the past ten years?

Chart 1: Global equity market *Value* vs. *Growth* 10Y, Performance in euro, net dividends taken into account, Source: Refinitiv Datastream, data as of 25 March 2021

A chart tends to say more than a thousand words. Some findings from the past ten years are obvious right away. *Growth* shares have clearly outperformed *Value* shares, recording twice their return (in euro, including dividend payments). While both market segments were neck-and-neck until 2016, the market has clearly favoured *Growth* in the recent five years. This could lead to the simplified conclusion that *Growth* is better than *Value*. But looking only at past performance can be treacherous. There is a reason why prospectuses state that “historical performance data of an investment are not indicative of its future development”.

## All just a question of valuation?

### Price-earnings ratio (PER)

There are numerous indicators that one can resort to in valuing equity markets. In the following, we will look at two in detail in order to be able to assess *Value* vs. *Growth* in more detail, i.e. the price-earnings ratio (PER) and the dividend yield.

Let us start with the PER and let us assume company A generates 5% profits in terms of its market capitalisation (price). The resulting PER is  $100/5 = 20x$ . By comparison, company B only makes 2.5% worth of profit, which results in a PER of  $100/2.5 = 40x$ . These ratios are not fictitious but are based on the actual valuation metrics of *Value* vs. *Growth*, as the following chart illustrates.

Chart 2: Global equity market *Value* vs. *Growth* PER 5Y, Source: Refinitiv Datastream, data as of 25 March 2021

The PER of the *Value* segment of the global equity market is currently at 21x, while at 42x, the PER of *Growth* is twice as high. The chart clearly highlights that this valuation gap has been widening in recent years. This means that *Value* commands a lower valuation, but also posts lower growth rates. Please note that the valuation of a company is not only based on the current profit (in the case of the current PER), but also profit expectations for the coming years.

The aforementioned comparison of both segments is based on a customary valuation ratio. But, excluding capital gains for a moment, what do investors get if they just hold their shares?

## Dividend yield

Dividends are the reward for long-term shareholders. A high dividend can only be paid for the long run if company earnings are high as well. Let us look at *Value* and *Growth* on the basis of dividend yield.

Chart 3: Global equity market *Value* vs. *Growth*, dividend yield 5Y, Source: Refinitiv Datastream, data as of 25 March 2021

At about 2.7%, the current dividend yield of *Value* is about four times that of *Growth*. *Value* companies often distribute a large part of their profits as dividends, whereas *Growth* companies plough them back and invest them into the expansion of their business.

## Or do other factors play a role?

As we have seen above, Growth shares currently command significantly higher valuations than dividend (i.e. *Value*) shares. Investors have clearly preferred the former over the latter in recent years and have thus been able to ride a wave of outperformance. A growth rate of +50% or more makes for a better headline than a dividend of 2% or 3%.

What has history taught us?

- No trend lasts forever
- Sales and earnings growth are priced into the share prices years ahead and have to be supported by actual company results

After many years of rising prices, a lot of investors are mainly invested in *Growth* and the story behind it. In the wake of the corona crisis, many companies have had to cut or even suspend their dividend payments from March 2020 onwards. This gave a further relative boost to *Growth*, putting *Value* thoroughly out of fashion.

## Conclusion

**Dividend shares have been sidelined by investors in recent years. At the moment, however, their valuation is significantly more attractive than that of the *Growth* segment, making them worth a serious consideration.**

**By the way, to many investors, the origin of their dividends is important. They increasingly attach importance to whether the profits and thus dividends of the companies are coming from a sustainable business model.**

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## Johann Griener

Johann Griener has worked at Erste Asset Management in Sales Retail since 1 January 2001. In this function he supported for example the Sparkasse banks in Austria, with a current focus on Upper Austria. His scope of duties includes the servicing, training, training and education of Sparkasse employees who work in the securities field. This means creating and holding presentations in the local branches and in Erste Asset Management for the purpose of promoting sales of Erste Asset Management GmbH and Erste Immobilien KAG funds. He also supports the Sparkasse banks (Austria-wide) in their own investments (nostro business). In addition, Griener is developing numerous publications for internal and external use. The "1x1 of Investment Funds" that he wrote is found in all of the branch offices of Erste Bank and the Sparkasse banks as basic reading and an introduction for customers on how investment funds work.

Griener began his career in 1988 as an employee at the bank counter in a local Sparkasse bank. There he learned the banking business, from a savings book to loans to investment operations. After a few years at the Sparkasse, he decided to continue his studies at the Vienna University of Economics and Business, with a focus on "banks" and "securities". After completing his master's degree, he remained loyal to the Sparkasse sector and has been working at Erste Asset Management since.

His motto: "Only a day with laughter is a good day"