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What is it about dividends on stocks?

Dieter Kerschbaum

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Investors are happy about rising share prices on the stock exchange. But in addition to rising prices, there is another factor that makes listed companies an interesting investment, especially in an environment of low interest rates like the one we have been experiencing: the annual dividend that companies distribute to their shareholders.

Dividends make the portfolio more stable

In the quest for attractive shares, one should take into account dividends, given that interest rates have been low in comparison with the past. Statistics show that dividends can positively influence total return. Companies that can afford to pay out a dividend often have a high market capitalisation and have been on the stock exchange for a long time. Companies that pay out parts of their profits as dividends to their shareholders have a strong basis and the sort of earnings power that allows them to absorb setbacks during times when share prices are fluctuating more significantly.

Dividend-stocks shares are not a better form of bonds

Dividend shares can help investors offset the lack of interest income in their portfolios. However, they are not bonds. Bonds and shares are two different types of assets: a bond investor lends the government or a company money for a specified amount of time. In return, he or she receives regular interest payments, but does not participate in the profit or loss of the company. Buying shares in a company means to become (co-) owner; as a result, the investor participates in profits but may also have to accept losses during down times. Therefore, the price risk inherent to share ownership should not be underestimated.

What does a high dividend yield mean

The dividend yield is a ratio that measures the return accruing to the investor from the company's profits. It is the ratio of dividend (per share) to share price, multiplied by 100.

Example

Companies distributing high dividend in 2019

According to analyst estimates, listed companies will, like last year, distribute high dividends in 2019. The dividend yield 2019 for the US index of the 500 biggest industrial companies (S&P 500) should average 2.2%. Estimates put the average for the Nikke index at 2.3%, and the dividend yield estimated for the companies in the Euro Stoxx index is 3.9% (sources: consensus estimates, Bloomberg). By comparison, the yield of a 10Y German government bond is currently negative; -0.123%, to be precise (source: Bloomberg; as of 15 May 2019).

It is worth keeping one's eyes on the ratios

The dividend in absolute terms is not the only parameter one should keep an eye on, as a higher dividend may also mean that the share price has fallen. The important aspects in this context are for the dividend to be paid out regularly, reliably, and for it to increase in the long run. In addition, other ratios (e.g. earnings, cash flow, ROE) should also be taken into consideration. Just like with all investment strategies, it makes sense for dividend papers to diversify one's investments and to set up one's portfolio on a broad basis. If you do not have time or do not feel like analysing dozens or hundreds of companies, you could leave the selection of suitable dividend shares to the experts of investment companies.

"Double dividend" with the ERSTE RESPONSIBLE STOCK DIVIDEND fund

To this end, we have created funds like ERSTE RESPONSIBLE STOCK DIVIDEND. In addition to the above-average dividend yield of 4.2%, the fund also offers another benefit: only those shares will be taken into the portfolio that pass the sustainability filter of Erste Asset Management. What does that mean?

"A team with numerous members examines the respective companies thoroughly as to whether they comply with the [ESG criteria (environmental, social, governance)] and are justifiable from an ethical point of view," explains the strategist Alexander Sikora-Sickl.

Picture: Stratege Alexander Sikora-Sickl

Low-volatility strategy to minimise risk

Whereas a portfolio of globally listed shares had lost more than 13% by the end of last year, a well-managed dividend fund such as ERSTE RESPONSIBLE STOCK DIVIDEND only incurred a decline of about 6.5% (source: Bloomberg, Erste AM). This means it helped contain losses, and like the statistics illustrate, the fund then managed to gain almost as much as the broad market in the subsequent upswing. This success is based on an investment strategy that has low volatility at its core (i.e. low share price fluctuations). The portfolio strategist Sickl therefore pays particular attention to the fundamental quality of the companies he scrutinises. The EBIT margin of the companies in the portfolio is 33%, free cash flow is 4.6% (source: Erste AM, own data, March 2019).

Dividends

In phases where stock market prices are more volatil, such as at the end of 2018, for example, a dividend strategy is in advantage, see the chart. If the stock markets are going to have an longer period only climbing up, the dividend strategy will be less price-relevant. Note: Past performance is not a reliable indicator of future performance. Note: Due to the short maturity, the performance has little meaning. Past performance does not allow reliable conclusions to be drawn about future developments.

The portfolio of ERSTE RESPONSIBLE STOCK DIVIDEND currently consists of a broad mix of regions and sectors: we have recently stepped up the purchase of shares from Australia, Canada, and Germany as well as of companies with strong dividends from the utility, industrial, and financial sectors.

Summary

The dividend is an important component of the total return of a share. To select attractive dividend titles requires a close look at the financial strength of the company. Be careful: a high dividend yield is not always a purchase argument for a share. This is the case when the stock has already fallen in price due to unfavorable business performance, but the expectations for the upcoming dividend have not yet been adjusted. A dividend strategy suggests that price volatility for high-dividend companies is lower than for companies that pay little or no dividends. Anyone who wants to invest in equities, but does not want to accept the entire fluctuation risk of a stock exchange, is in good hands with high-dividend equities and funds.

Legal note:

Prognoses are no reliable indicator for future performance.

Dieter Kerschbaum

Communications Specialist Austria, Erste Asset Management