

Investor Insights

High Dividend Equity

Dividends are an important income generator

History has shown dividends are the primary source of total equity return

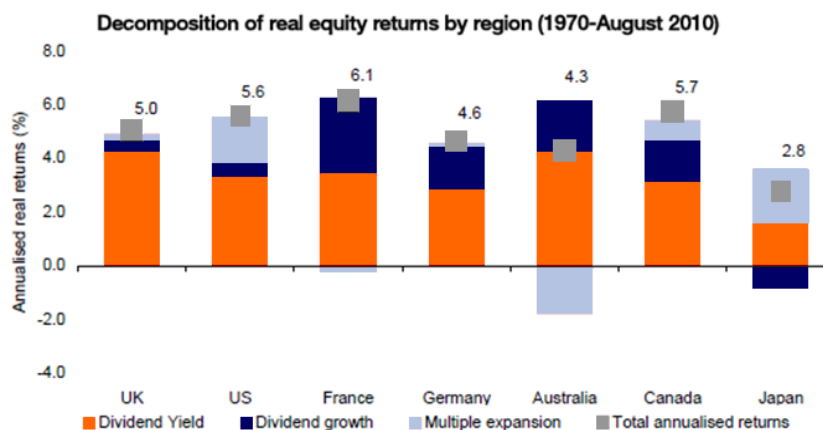
Pursuing a more attractive risk-return profile: lower volatility more defensive equity market exposure

Dividends remain less volatile than earnings and are a stable and reliable valuation tool

Are investors considering the pursuit of dividends as an important source of investment return? Or are they largely ignoring the power of dividends and seeking price appreciation only? In this article, we present evidence to demonstrate that high dividend strategies continue to provide significant opportunities for investors.

In the long run, dividend yield and dividend growth represent the majority of total equity return. A breakdown of equity returns over the past 40 years shows that, for an investor with an investment horizon of at least 5 years, more than 70% of the total equity return was from dividend yield and dividend growth (1). Capital gains only represented less than one third of these returns.

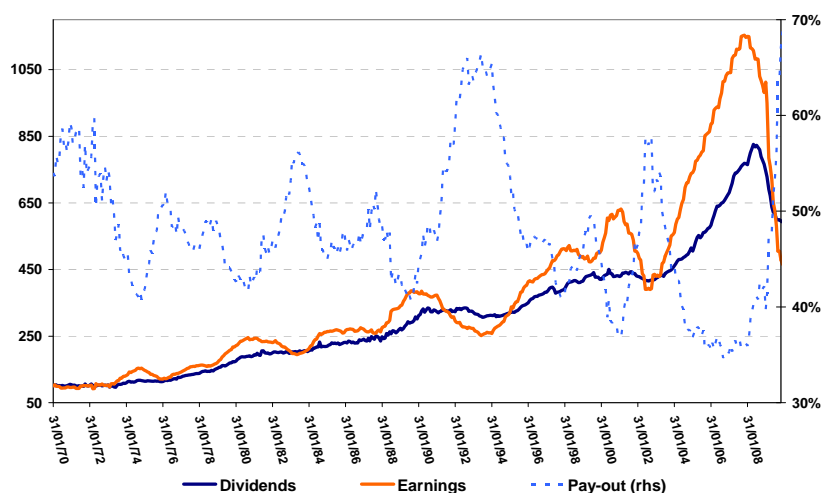
Figure 1: Dividends are the biggest driver of equity returns



Sources: MSCI, SG Cross Asset Research, Thomson Reuters Datastream

As shown in the table above, dividend yield is the only positive source of return over time, whilst both capital gains and dividend growth can be negative. This provides high dividend strategies with a strong source of return with clear defensive characteristics, when compared with traditional equity funds. High dividend portfolios offer lower volatility and more defensive exposure to equity markets, but with upside participation.

Dividends are important due to their stable and defensive characteristics. Since dividend growth is far less volatile than earnings growth (Figure 2), especially during periods of economic contraction, they provide better insight into expected future stock price performance. A relatively high dividend regularly limits the downside price risk. When a company increases its dividend, it becomes more attractive to investors and the stock price generally tends to increase, providing investors with a two-fold benefit. For example, during the global financial crisis, companies that maintained or increased their dividend payouts generally suffered less than those that either decreased their payouts or stopped paying dividends altogether.

Figure 2: Dividends are far less volatile than earnings

Sources: ING IM Value Team, MSCI World data in US\$ from 1970 – 31 May 2010.

Dividend-paying companies are more likely to outperform and outlast their non-paying peers

A loss-making company cannot afford to pay dividends; hence dividend-paying companies tend to be profitable. Furthermore, the management teams of companies with long term track records of stable and increasing dividends tend to show their loyalty to their investors by sharing their earnings. Since a stock's investment return depends largely on a company's fundamentals, the management teams' commitment to improving these fundamentals imply that such companies are more likely to outperform.

Managing high dividend strategies for success

Like managing any strategy for success, we believe there are several golden rules to be applied when managing high dividend strategies (2).

Rule Number 1: A focus on dividend sustainability usually means a quality bias

Where some investors may focus on the maximization of dividend yield, our view is that a more effective strategy is to target companies that:

- 1) offer a dividend yield above 2.5%, and
- 2) have the potential to grow their dividends in the future. This strategy stresses the importance of dividend quality and sustainability.

Rule Number 2: A strict buy-and-sell discipline is required

To ensure that the strategy is predictable and systematic, a strict buy-and-sell discipline should be adopted. This means selling the entire position in a stock when the dividend yield drops below 2.5%. This systematic stop-loss process ensures that profit is taken on high performers, whilst re-investing the proceeds into other undervalued companies.

Rule Number 3: Adopt an equally-weighted approach

The starting point should be to allocate equally-weighted positions of, for example, 1.5% in the stocks that have been selected as the result of rigorous stock screening and analysis. The analysis would combine a quantitative screening (dividend stability, liquidity and a dividend yield above 2.5%) with a thorough fundamental company analysis. If there is high conviction on a particular stock, its position can be increased to 3%. A stock position would be rebalanced when it reaches 5%, thereby locking in profit and making way for another stock that meets our criteria.

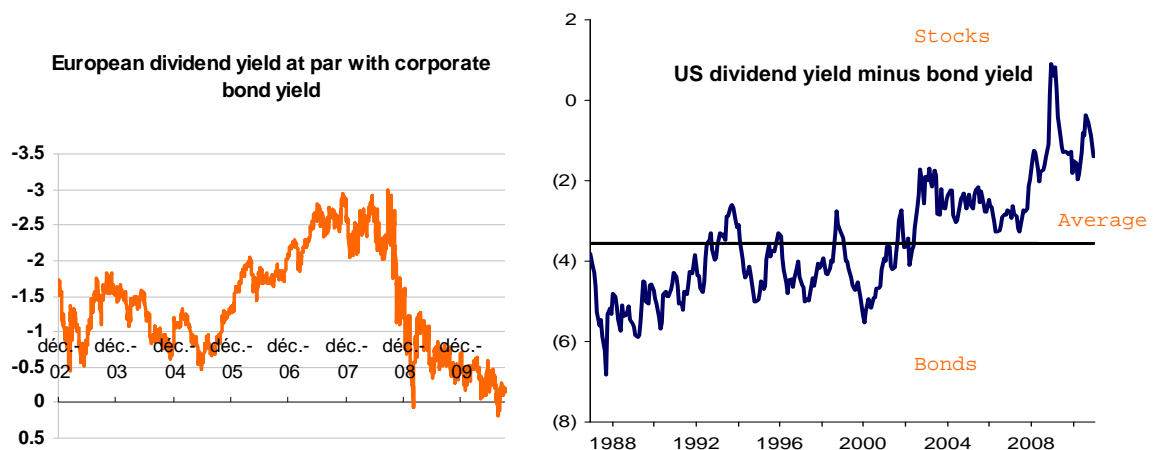
Rule Number 4: Ensure portfolio diversification and tight risk management

To avoid inherent concentrations of risk, diversification should be ensured through regional and sector exposures, as well as the use of advanced risk models to analyze the overall portfolio risk profile.

The outlook favours high dividend strategies

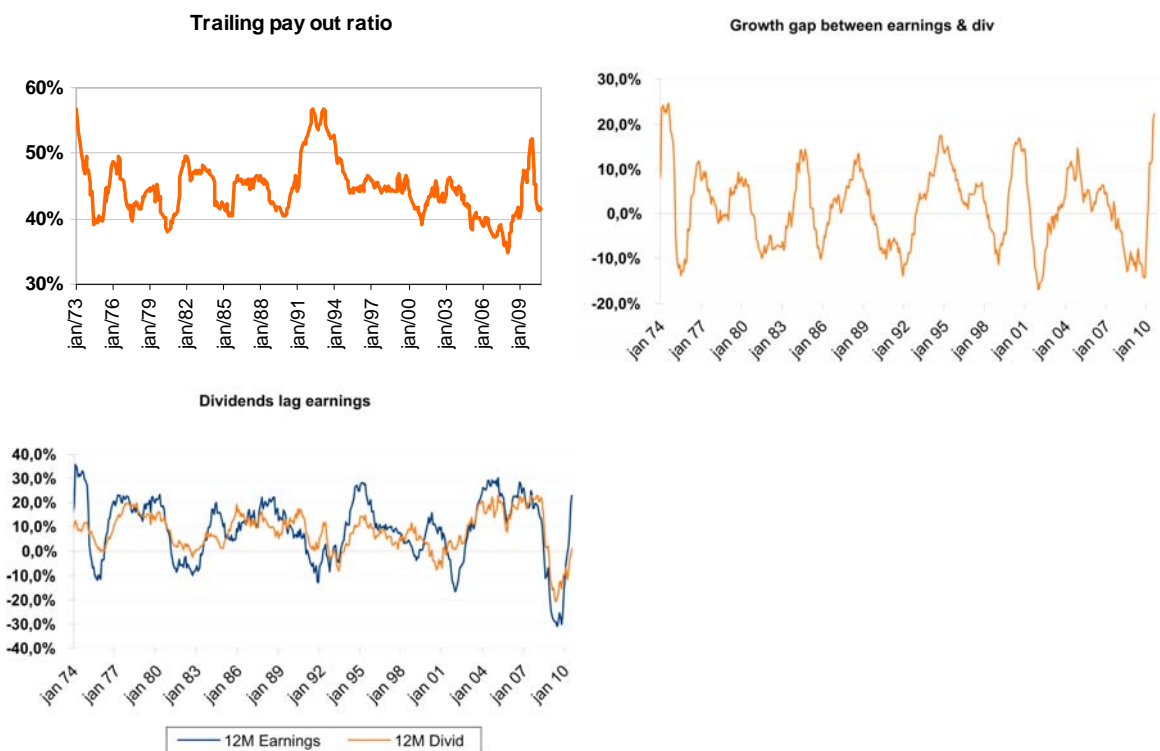
Amidst a continuing global search for yield, we believe that current market dynamics favour high dividend strategies, as dividends become more important as an income generator within a sustained low interest rate environment. Dividend yields are approaching or exceeding bond yields, especially in developed markets, as shown in Figure 3. Indeed, within the S&P 500, for example, there are now 58 companies offering dividend yields in excess of the AA 10-year corporate bond yield of 3.85% (3). Dividends tend to lag earnings and Figure 4 shows the expected growth gap between earnings and dividends. We expect near-term dividend growth to be supported by strong corporate balance sheets, low payout ratios and high profitability resulting from the cost reduction measures implemented after the global financial crisis.

Figure 3: Dividends are approaching or exceeding bond yields* in developed markets



Sources: Standard & Poor's, Reuters, FactSet * 10-year corporate bond yields

Figure 4: The importance of dividends in developed markets



Sources: Datastream, ING IM

What does ING have to offer in the High Dividend space?

ING, a global investment manager, has been a pioneer in the high dividend concept since early 1999, and has a successful 10-year track record in this segment, with consistently good performances, both relative to our peers and to other more traditional equity strategies. This is mainly attributable to our highly qualified and stable ING Value Team, a small and flexible alpha-focused team consisting of 6 portfolio managers with an average investment management experience of 13 years.

Endnotes

- (1) The Global Income Investor, Quantitative Research, SG Cross Asset Research (Feb 2009)
- (2) ING Investment Management
- (3) ING Investment Management

Disclaimer

This document is prepared for general information only and shall not be transmitted, disclosed or copied, or relied by any person for whatever purpose. It does not have any regard to the specific investment objective, financial situation and the particular needs of any specific person who may receive this document. Any opinion, view or estimate presented is subject to change without notice and is made on a general basis and is not to be relied on you as investment advice. The information contained within this document has been obtained from sources that ING Investment Management Asia Pacific (Singapore) Ltd ("INGIM SG") believes to be reliable and accurate but no representation or warranty, expressed or implied, is made as to the fairness, accuracy, timeliness or completeness of the information. Neither INGIM SG, nor its affiliates or any director or employee accepts any liability whatsoever for any loss arising directly or indirectly from any use of the information in this document. This document and information presented do not constitute a distribution, an offer to sell or the solicitation of an offer to buy any securities in any jurisdiction in which such distribution or offer is not authorised to any person.

Any past performance, projection or forecast made is not necessarily indicative of future performance. The price of any security may go up or down.. Reference to specific securities (if any) is included for the purpose of illustration only and should not be construed as a recommendation to buy or sell the same. An investment in any financial products mentioned in the document is not intended to be a complete investment programme for any investor and prospective investor should carefully consider whether an investment in such product is suitable for them in light of their own circumstances, financial resources and entire investment programme. An investment in any financial products mentioned in this document carries risk. The financial product may not suitable for persons who are averse to such risks. The information in this document may not be copied, reproduced or redistributed in whole or in part without the prior consent of INGIM SG.

By accepting delivery of this document, you irrevocably understand, acknowledge, agree and accept the foregoing disclosures.

ING Investment Management Asia Pacific (Singapore) Ltd
Company Registration No: 199602506R