

## THE SILENT FACTOR IN INVESTING

There is a largely ignored section of the *Wall Street Journal* that we observe each day. The "Markets Digest" section of both the print and online versions of the *Wall Street Journal* includes a small section titled "Dividend Changes." It almost always appears toward the bottom of the page, and we doubt that many investors review this report. We consider it to be very important information for serious investors since it identifies any dividend increases announced on the previous day. Dividend growth is one of our favorite investment characteristics because we have seen what it can do for shareholders over the longer term.

We often refer to dividend increases as "the silent factor." Why? Because dividend growth as it is occurring garners small attention among most investors. It can almost go unnoticed, seldom making headlines despite its importance. Dividend increases, most typically, are quiet, if not silent, working their influence in relatively small measures that add up greatly over time. We fully acknowledge that news of a dividend increase is not nearly as exciting as a big jump in the price of a stock because of a better-than-expected earnings increase or some merger or acquisition activity. Furthermore, on a short-term basis, it may not affect the price of a stock at all. It is almost as if it is occurring under the surface, a stealth event, but one that we believe can make a powerful impact if achieved regularly over the long term. Dividend increases add up over time, compounding under the surface to the shareholder's benefit. This is certainly one of the factors that gradually pushes the price of a stock upward or supports it in periods of economic stress. We also know that investing in companies that raise their dividends on a very consistent basis brings other attractive characteristics as well.

We have previously quoted Jeremy Siegel, noted author, professor, and market commentator who puts his stamp of approval on the importance of dividends and their impact on the price of a stock. He says, "The importance of dividends in generating stock returns is not just historical happenstance. Dividends are the crucial link between corporate profits and stock prices." Enjoying the income that comes with dividends is one thing, but because of this link with earnings per share, rising dividends also contribute to price appreciation. It is the combination of dividend yield and stock price appreciation that adds up to total investment return, the ultimate goal of any stock investor. In order to properly benefit from and fully exploit "the silent factor," there are essential ways of looking at the broader issue of investment. We discuss several.

**OWNERSHIP AS ESSENTIAL TO INVESTMENT.** Common stock investors come in many stripes. Some think of stocks as pieces of paper that can be traded often as a way of gaining a quick profit. Others attempt to time the market for stocks, believing they can get in on an upswing and get out when there is trouble brewing. Some play stocks as a cyclical opportunity, attempting to tie their performance to macroeconomic factors or cycles. We believe a focus on "the silent factor" is superior, for it aligns the shareholder with the company in much the same way as a business owner and their company. Benjamin Graham, known as the father of value investing, said it best when he advised investors to evaluate a company as if there were no price for it and decide what the merits of the company would justify. This comes close to the true meaning of ownership. There is a mindset of an actual owner of a company and undeniable alignment of interests. As growth occurs, owners can derive benefits from both dividends and increases in the value of the company. Our investment discipline involves a comprehensive research process which is a serious study of the merits of a company. The process assumes our ownership will be long-term, and as such we are seeking to reap the dual benefits of both income and appreciation.

**LONG-TERM INVESTMENT HORIZON.** We have already stated that “the silent factor” cannot make you rich over the short term. But it can certainly contribute heavily to wealth generation over the longer term. Compounding is not a short-term game, but it is a wonderful long-term game.

Consider “the silent factor” working its way in a particular stock that pays a dividend of \$1.00 and trades at a price of \$40, thus producing a current dividend yield of 2.5% (income/price). Assume this company has high-quality characteristics and has been increasing its dividend very consistently over time. There are many examples of companies offering a similar dividend yield that can sustain at least a 6% dividend growth rate over time. In this case, if the dividend is increased consistently at 6% for the next ten years, the annual payout will have grown from \$1.00 to \$1.90. Applying that dividend rate to the current share price of \$40 produces a dividend yield (on cost) of 4.5%. All things equal, and unless stock valuation declines for some reason, the shares will trade at a significantly higher level. If the stock still yields 2.5% ten years later, its price will be \$76. Such a result would be satisfying, for the investor has received growing income from the dividend, and the stock price is much higher. This simple example, one that is certainly within the realm of possibility, helps illustrate how a rising dividend can push the price of a stock higher over time. But even if the stock is not higher the investor is enjoying an attractive stream of rising income, and the fundamental progress of the business represents embedded value that is waiting to be unleashed.

Again we make the point that this can be a slow process requiring patience. It is closely aligned with the concept of ownership which involves a longer-term commitment. We believe it is a lower-risk way of investing with very high odds of success over time. One other advantage, we believe, is the liquidity afforded by the capital markets, along with the ability to invest in these types of high-quality companies when the yield is above average or expectations on behalf of other investors are sufficiently low to enable outsized returns in excess of what the company is generating on an internal basis. This is where our fundamental research process is focused.

**AN ENTRANCE INTO QUALITY.** If you made it this far, we believe you are an investor, not a speculator. Investors are interested in quality as a characteristic of their portfolio, for this is the one durable investment factor that influences both risk and return. Quality is a central facet of what we do at Crawford and something we strive for in all of our investment selections. We feel one of the more attractive benefits of investing in “the silent factor” is that it provides an easy if not automatic means of accessing quality. Companies that raise their dividends on a very consistent basis almost always possess the characteristics that place them in the quality category. Among these quality attributes are businesses that have proven their stability and sustainability over a long period of time (low earnings variability), financial strength (most often measured by the balance sheet), and high returns (most typically return on equity). Secondary attributes often include strong management teams, substantial market share positions, and sound capital allocation practices that include reinvestment back into the business along with shareholder-friendly policies reflected in consistently rising dividends.

What does quality do for an investor? Mainly, it reduces the range of potential outcomes for an investment and provides a higher level of confidence that the ultimate outcome of the investment will be favorable. This outcome can be further enhanced by applying a price-sensitive approach to selecting stocks. In our view, “investment” in its comprehensive definition encompasses income generation, growth in value over the long term, and preservation of capital. We believe investing in companies that provide “the silent factor” has the potential to satisfy all three of these objectives.

**Disclosure**

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