

Income & Growth of Income

Why Dividends Matter

At Crawford Investment Counsel all of our equity strategies are dividend-oriented. We believe that dividends are an essential element for serious, long-term common stock investors. In this paper we outline what we find so attractive about the income component that dividends bring to a portfolio of stocks.

John Burr Williams, writing in “The Theory of Investment Value” in 1938 stated:

A cow for her milk, a hen for her eggs,
And a stock, by heck, for her dividends.
An orchard for fruit, bees for their honey,
And stocks, besides, for their dividends.

Williams, a pioneer in developing rigorous methods of determining the intrinsic value of stocks, was also practical in his approach. No great poet, his little verse on dividends at least points to their basic importance.

We share Williams’ delight for the unsung benefits of dividends and believe all investors would be wise to consider them as well. As an equity investor, one desires some type of return, and the safest and most assured way of obtaining this is through the dividend. When all the attractive attributes of dividends are considered, among the most favorable is the fact that the income component of total investment return is always positive.

Silent Factor in Equity Returns. Over time, the impact of dividends on total investment returns is significant. Research shows that since 1930, dividends have accounted for roughly 40% of the total return of U.S. stocks.* This figure comes as a shock to many investors, as the common assumption is that dividends are only a minor contributor to the total return of stocks. We like to refer to dividends as the “silent factor” in a portfolio. Dividends are not normally headline-making events, but over time they quietly build up and create a larger impact on returns.

Buying stocks that pay dividends is a reasonable way of achieving the goal of having some current return on your investment. Investors may buy stocks for any number of reasons. Most often, there is the expectation that they will appreciate in value and provide a profit. One way to think about dividend-paying stocks is to contrast them with stocks that pay no dividend. If a stock does not pay a dividend, the investment return is 100% tied to what someone else will pay for the stock. Conversely, dividend-paying stocks have an income component contributing to the total investment return and an intrinsic value attributable to the future cash flows from dividend payments.

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If the price of the stock goes up it will be the result of other investors changing their minds about its value and bidding it up. But there is no guarantee that this change of opinion will occur, and if it does not, the investor would be left with no return. Obviously, in terms of safety of return, or assuredness of some return, the dividend-paying stock has the advantage over the non-dividend-paying stock.

Dividend Growers. Beyond the security of returns that dividends provide, we also look to the future and determine what type of total return might be earned from a stock over the longer term. Indeed, our approach is not only to invest in companies that pay a dividend, but to ferret out those companies that increase their dividends on a regular basis. This begins to get at the heart of our approach to investing.

- There are a couple hundred companies that meet the standard of increasing their dividend in each of the last 10 years.
- There are another one-hundred plus companies that have paid the same or higher dividend for at least the last 10 years.

This total of approximately 400 companies with a history of consistent dividend payments represents our universe of potential candidates for purchase in our flagship portfolio strategy. Importantly, this group of companies meets a rigid test of consistency when one considers there are some 4,000 publicly traded companies. It is their consistency that draws us to these type of companies. These dividend-paying companies tend to sell products that are in continuous demand, and therefore are able to keep their sales, earnings, and dividends in a relatively stable pattern, even in difficult economic settings. Even so, more is required than a stable of in-demand products; consistent businesses also require strong balance sheets, capable management, and in many cases, substantial market share positions. These are all attributes that enable businesses to perform with consistency and, for our purposes, continue to pay and raise their dividends on a regular basis. We find especially compelling an attractive dividend yield that is also growing over time.

Conclusion. It is our belief dividends matter for a number of reasons. We have dealt with one of the most important ones: the ability to provide income. Dividends also matter because they have the potential to make stock prices increase. They matter because they provide downside protection in difficult market environments. They also matter because they are an excellent indicator of quality. These are among the primary reasons we favor dividend-payers and growers in our stock selection process.

*Source: Fidelity Investments and Morningstar, 2020

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