

Origins: Crawford Dividend Growth Strategy

Considering the fact that Crawford Investment Counsel is now in its fifth decade of existence, it seems appropriate to review its oldest and largest equity investment strategy: Dividend Growth. The idea for this strategy actually originated in the early 1970s with me, John Crawford, when I was employed by another investment management firm. It has a long and successful history of serving the needs of both private and institutional clients. The strategy has stood the test of time and scrutiny. In this paper we will describe the circumstances of its origin and will follow in subsequent papers how the strategy has evolved and what its proper applications are. I will adopt the first person since the narrative is personal to me, a story that I very much enjoy telling.

The old saying, “necessity is the motherhood of invention” is a good way of introducing the story of the origin of the Dividend Growth strategy. The necessity was that I responded to the needs and desires of a client and found an investment approach that would satisfy the client as well as my employer at the time. My investment management career began with a New York based firm that had a regional office in Atlanta. After working in the home office for a few years, I was asked to transfer to Atlanta to take a portfolio management position there. Upon arrival I inherited a brand new client relationship with a large regional hospital in the southeast. This institution was just beginning its investment program, which was fortuitous since I was able to get started with this client from the very beginning of their investment history.

The president of the hospital, let’s call him Dr. Smith, was a giant in the health care industry, and while he was an amateur investor, he had very strong views about investment. He always knew what he wanted. One of his strong suits was the fact that he was long-term in his investment orientation, and he was realistic about return expectations. Most important, he liked yield on his stocks. For him, a bird in the hand was always better than one in the bush.

My employer at the time was a firm that employed a growth stock strategy. I should note that the emphasis, while on growth, was also on quality. From my early experience there, I learned the wisdom of investing in quality. But the growth orientation was extreme, essentially defined by the term “nifty fifty.” This term was applied to a group of companies that were believed to have sustainable growth at very high levels. The businesses of these

Origins: Dividend Growth

companies were assumed to be so impervious to cyclical downswings in the economy, and thus of such high quality, that investors bid these stocks up to very high multiples of earnings, in many cases as high as fifty to one hundred times earnings. In short, they were very expensive. Furthermore, because their prices were so high, the dividends that were paid produced only modest yields. Since I was representing my employer as the portfolio manager for this client, these were the types of names I purchased for them when I began to invest. Examples were: IBM, Digital Equipment, Xerox, Avon Products, International Flavors and Fragrances, among others.

A few months into the relationship Dr. Smith called me over for a visit. After pleasantries, he asked regarding the investments we were making, saying, "John, what are you doing?" Somewhat taken aback I replied, "Why Dr. Smith, I am buying you some of the greatest companies in the world." Not satisfied, he then asked, "Where is the yield?" Lacking in tact, I said, "Dr. Smith you do not need yield because these stocks will be growing so fast, and their prices will rise faster than any dividend." Dr. Smith showed his patience with me, and we continued our discussion of yield versus growth that day and on several other occasions. Finally, after going back and forth on this subject and feeling the need for resolution of the issue, I said, "O.K. Dr. Smith, what is it going to be, yield or growth?" His answer to this question formed the very genesis of the Dividend Growth approach. He said, "Why not both?"

Faced with what seemed like an impossible task, I immediately got back to my office and began looking for stocks that might do two things: one, satisfy my client, and two, satisfy the company I worked for. I needed yield and growth, two seemingly contradictory characteristics. What I discovered, however, was that there were always a few companies that had previously been growing steadily and increasing the dividend consistently, but because of some temporary circumstances in the underlying business, the stock was depressed. Depressed stock prices on top of a good dividend produces higher yield. Looking for this combination not only offered up stocks with growth and yield, but also introduced the characteristic of value to the stock picking process. Buying really strong companies with a consistent dividend, while down in price, became the blueprint. Fortunately, this selection process, while intuitively subjective at the time, proved sound, and the results were good. The approach not only provided us with the desired yield, but because of the growing dividend and improving fundamentals, the stocks began to move up in price. As it turned out, the total investment return we were earning was very satisfying. Thus began an investment approach that is employed to this day, and as noted earlier, has withstood the test of time and scrutiny.

Over the years the basic approach has remained the same, closely tethered to its philosophical roots. That philosophy starts with quality. First of all, we want to buy superior

Origins: Dividend Growth

companies. Within that context, the approach requires consistent dividends and above-average yield at the portfolio level. To this day we respond to the question, “Why not both?”

As we will describe in a future paper, this investment process has been developed into a more rigorous and disciplined system of investing. As noted, we call it the Dividend Growth approach. Its focus, thanks to Dr. Smith, has always been on dividend yield, and thanks to us, equally important has been the consistency of the dividend and how it helps us identify quality. It is not enough to own stocks that provide a high yield; the dividend needs to be growing consistently. It is not enough to just have high dividend growth; there must be some yield. We have always felt that striking a balance is best. If we can find stocks with moderate to high dividend yields and also have dividend growth, then we really believe we have the makings of a good investment.

We have described how this investment process began. We like to point out that it is an original approach in the sense that we did not read about it in a book, nor did we copy it from someone else. Instead, it grew out of a real life experience. It is based on classic investment theory. As another investment professional once said of it, “it is simple but elegant.” Most importantly, in our opinion, it produces successful results as it provides good upside participation while protecting on the downside. The combination of these two factors adds up to a more stable, less risky return pattern that has well served our clients for over forty years.

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