Seeking refuge in high forecasted dividends

July 2022

Research Signals

Since the start of the year, stocks have been challenged from several fronts including high inflation and central bank rate increases, alongside supply chain disruptions exacerbated by the war in Ukraine and renewed COVID restrictions in China. Almost every sector has sold off and, what is more, investors have not been able to turn to other asset classes such as bonds or cryptocurrencies to hedge their losses. So, what has been working in 2022? In this report we highlight strong performance associated with Leading 12 Month Total Dividend Yield from our proprietary Dividend Forecast factor suite.

- With dividend payments surging in the first half of the year, fueling our Dividend Forecasting team's expectation for 6.5% growth in global aggregate dividends in 2022, retail and institutional investors have gravitated to high dividend paying stocks
- The highest dividend yield firms outperformed non-dividend payers by significant double-digit margins across global regions over the past year and, in 2022, this signal surpassed other value indicators based on earnings estimate, particularly in Europe and Pacific regions
- Firms which passed our screen for attractive forecasted dividend yield include US-based Devon Energy and Energy Transfer LP and European banks Danske Bank and Natwest Group, while Danish shipping company A.P. Moller Maersk and American multinational beverage corporation The Coca-Cola Company are examples of firms with significant cash flow generation and an ability to maintain margins in a rising cost environment

Macro backdrop for dividend strategies

While markets have sold off with few places to hide, investors may find some comfort in dividend-paying securities. Global dividend payments have surged in the first half of the year, with aggregate payments up 13% as compared to the first half of 2021 (Table 1). Many companies continue to play catch-up from the dividend cuts, suspensions or stagnant growth of 2020 and early 2021. Overall, the IHS Markit Dividend Forecasting team (now a part of S&P Global), which delivers precise forecasts on the size and timing of dividend payments using

Contacts
Research Signals · MK-ResearchSignals@ihsmarkit.com

IHS Markit
now a part of
S&P Global

fundamental analysis, expects global aggregate dividends to increase by a total of 6.5% in 2022 to reach $2.2 trillion.

Forecasts show growth across three of the largest global regions, but at differing paces (Figure 1). European dividends are expected to grow 4% while those in the Americas are forecast to jump 10%. The APAC region should see 6.6%, held back slightly by a fall in dividends in Japan, one of the two largest markets.

Dividend strength by industry is largely expected to fall in-line with broader macroeconomic trends (Figure 2). For example, the banking and energy industries will benefit from central bank policy raises and globally high energy prices, respectively. Other rotational trends will also be present in dividend payments as consumer demand shifts from products to travel, with the travel and leisure sector expected to grow substantially. Meanwhile, personal care and healthcare are each expected to flatten, slowing from a banner 2021 that saw those industries benefit from pandemic spending.

Table 1

Dividend expectations by region

Aggregate payments (billions of dollars)

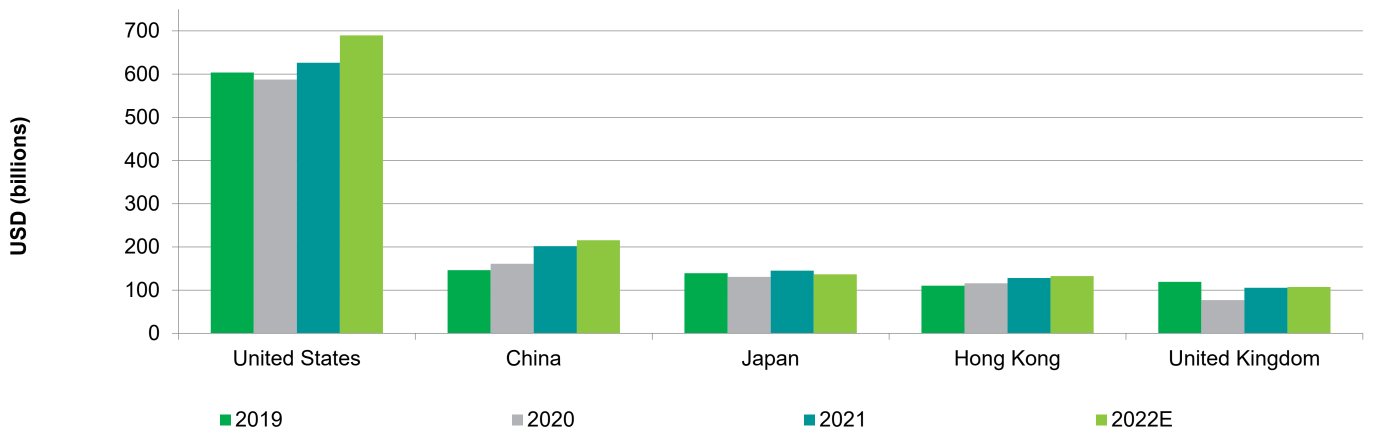
Name	2021	2022E	Increase (Expected)
Americas	764	846	10.7%
United States	626	689	10.1%
Canada	65	72	11.2%
Europe	442	460	4.1%
United Kingdom	106	107	1.7%
France	66	71	8.8%
APAC	743	793	6.6%
China	202	215	6.8%
Japan	145	136	-6.0%

Source: IHS Markit

Note: Individual countries are the two largest aggregate payers in each respective region

Figure 1

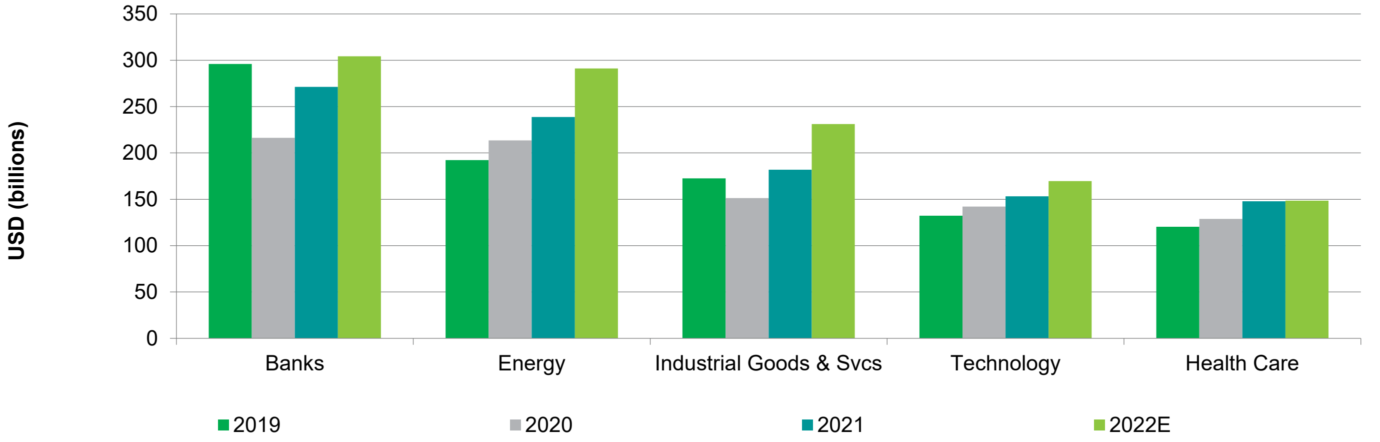
Top 5 dividend markets: Annual payout



IHS Markit

Figure 2

Top 5 dividend sectors: Annual payout

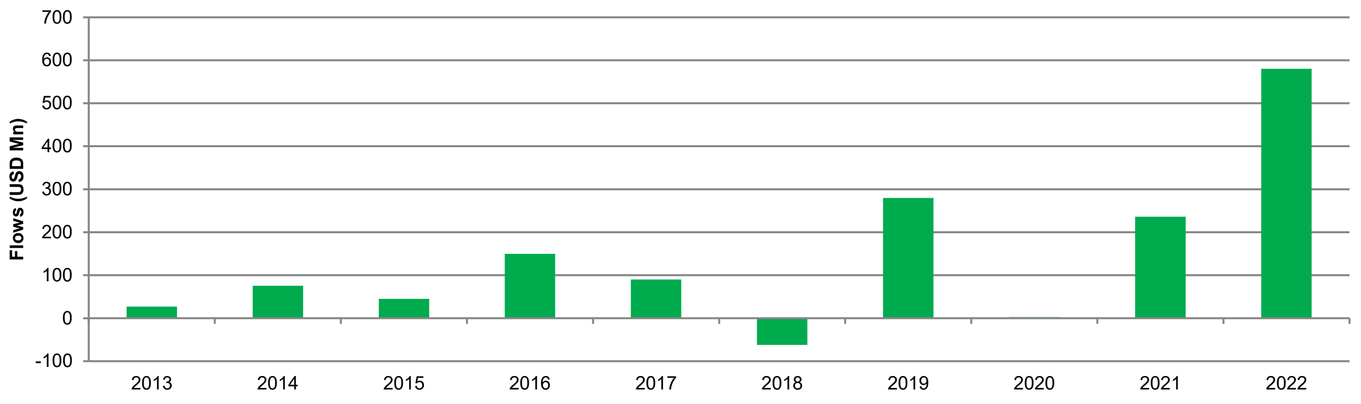


IHS Markit

Retail and institutional investors have shown signs of taking solace in dividend paying stocks of late. First from a retail perspective, we analyze flows in the SPDR S&P Global Dividend Aristocrats UCITS ETF as a proxy for retail activity, sourced from our ETF and Benchmarking Solutions division's ETF Analytics database. The objective of the fund is to track the performance of high dividend yielding equities globally. Through 11 July 2022, the fund has seen inflows more than double that of the prior year (Figure 3), reaching $580 million, compared with $236 million over the full year in 2021. Investors have been awarded with this positioning, with the fund losing just 5.4% in 2022 compared with a loss of 18.5% in the SPDR S&P 500 ETF (Figure 4).

Figure 3

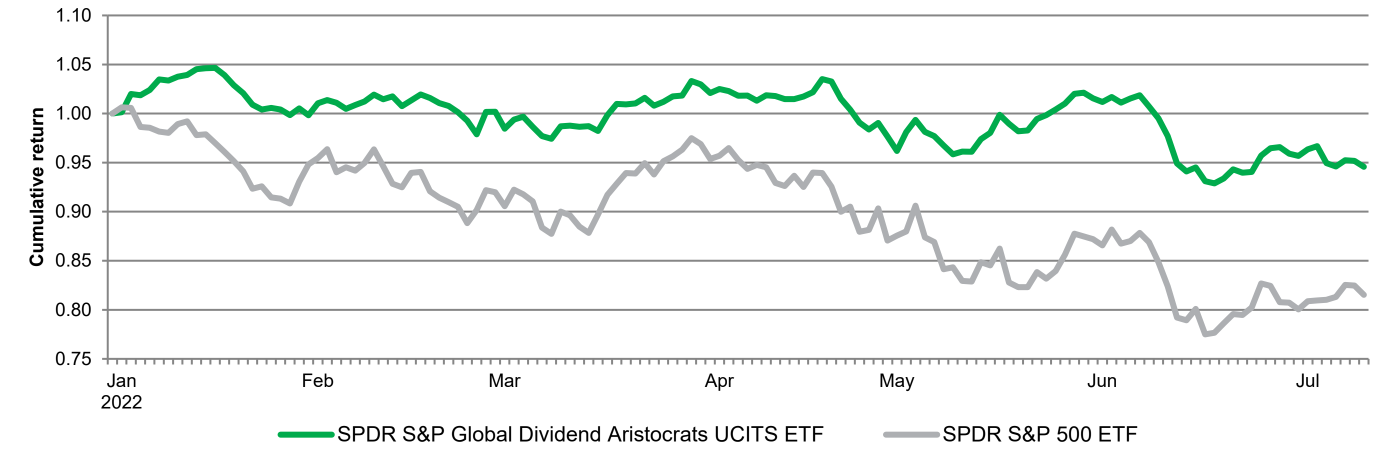
SPDR S&P Global Dividend Aristocrats UCITS ETF annual flows



Source: IHS Markit

Figure 4

Relative ETF performance



Source: IHS Markit

© 2022 IHS Markit

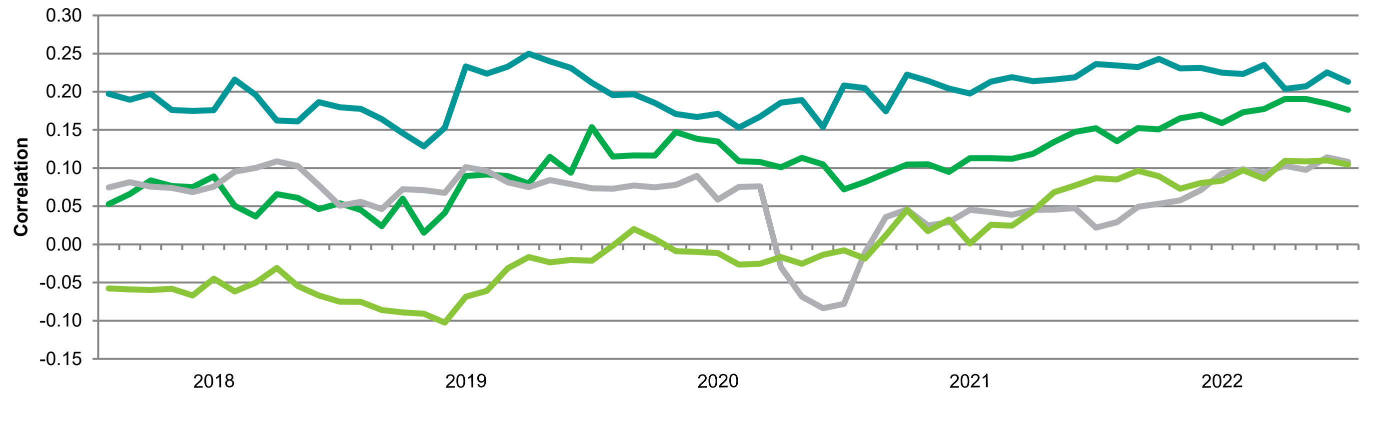
We gauge institutional investor sentiment in high dividend paying stocks using the Lending Supply factor from the Short Sentiment suite, sourced from our proprietary Securities Finance dataset, which captures daily supply, demand and borrow cost of individual securities in the lending market. Lending Supply measures the total quantity of stock made available by custodians in their lending programs relative to the total shares outstanding. It can be used as a higher frequency proxy of institutional ownership as much of the lendable supply comes from the custodians of pensions and mutual funds.

To assess the trend in borrow supply of high dividend yielding stocks, we examine the correlations in monthly cross-sectional factor percentile ranks between Lending Supply and Leading 12 Month Total Dividend Yield (Figure 4), where a higher correlation indicates more positive institutional investor sentiment. We report results across the US Total Cap universe, comprising approximately 3,000 of the largest cap names, with a further breakout of the US Large Cap universe (approximately the top 1,000 names). We also review the Developed Europe and Developed Pacific universes, representing 95% of the cumulative market cap of each member country subject to a minimum market cap of $250 million.

The results demonstrate an upward trend in institutions' favor towards shares with the highest projected dividend yield since mid-2020 across each region. The highest correlations are observed in the Developed Pacific universe, while Developed Europe experienced the largest increase.

Figure 4

Leading 12 Month Total Dividend Yield and Lending Supply rank correlations



Source: IHS Markit

Dividend factor performance in the spotlight

Next, we use our Stock Screener utility to highlight performance of select Dividend Forecast factors. To begin with, we focus again on Leading 12 Month Total Dividend Yield, which is a price-adjusted measure of our Dividend Forecasting group's estimate of regular and special dividends reflecting overall corporate actions over the next year.

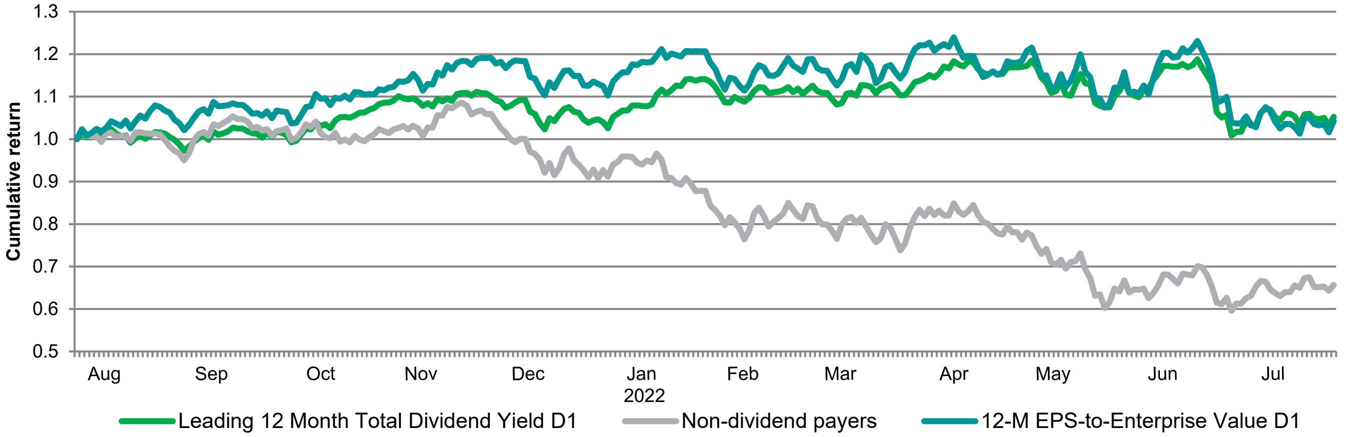
We create filtered portfolios based on the top 10% of dividend yield names (factor percentile ranks between 1 and 10), along with non-dividend payers (factor values equal to 0) and report the equal-weighted portfolio performance (note that there is a larger representation of non-dividend payers in the US compared with Europe and Pacific regions). For further context, we also include performance of the top 10% ranked names by 12-M EPS-to-Enterprise Value to test for changes in investor preference for value factors reflecting stability of dividends as opposed to perhaps unreliable earnings-estimate.

In the US Total Cap universe (Figure 5), we find that the top dividend yield firms outperformed non-dividend payers by 39.6 percent points over the past year. We also observe that the outperformance gained by 12-M EPS-to-Enterprise Value decile 1 shares over that of Leading 12 Month total Dividend Yield in 2021 gave way this year, with the dividend yield signal eking out a slight lead through 15 July.

In Developed Europe (Figure 6) and Developed Pacific (Figure 7), we again find outperformance of the top dividend yield names over non-dividend payers of 29.7 and 26.9 percentage points, respectively. Furthermore, we see a wider margin of outperformance of decile 1 shares based on dividend yield over that of the earnings estimate-based valuation at 6.9 and 8.7 percentage points, respectively, suggesting higher investor skepticism toward analyst estimates in these regions compared with the US.

Figure 5

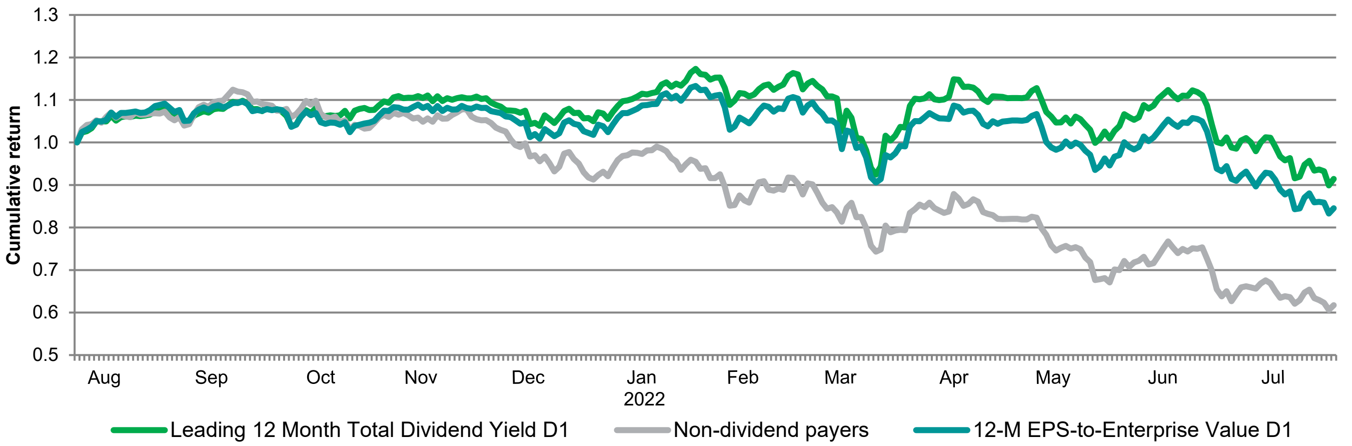
US Total Cap stock screener portfolio performance



Source: IHS Markit

Figure 6

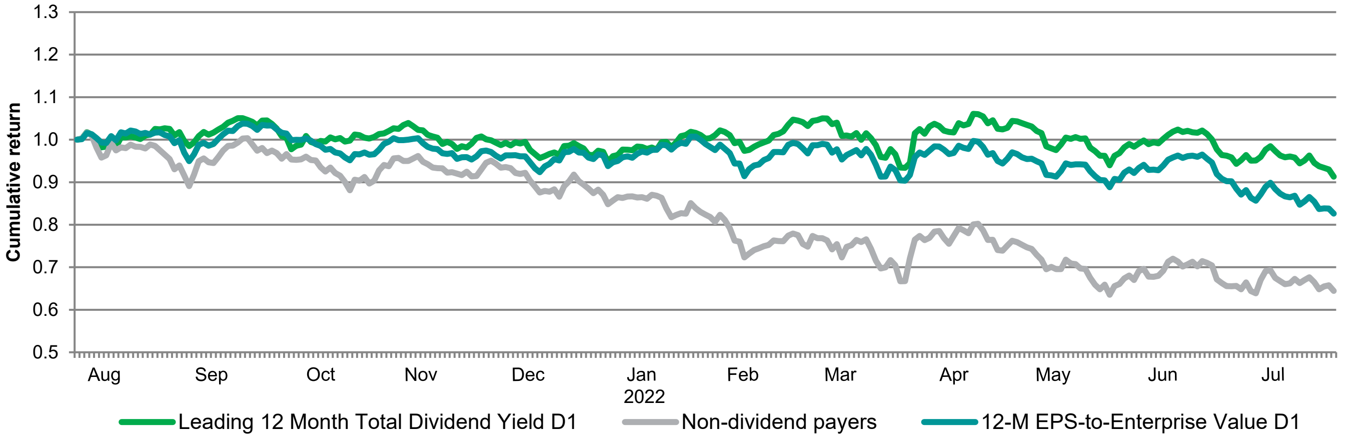
Developed Europe stock screener portfolio performance



Source: IHS Markit

Figure 7

Developed Pacific stock screener portfolio performance



Source: IHS Markit

Taking this idea a step further, we use our User Defined Model utility to create a multifactor strategy combining Dividend Forecasting signals with Short Sentiment indicators which may also benefit from higher levels of risk aversion in the recent market environment. For this study, we construct an equal-weighted model of Leading 12 Month Total Dividend Yield, 2-Year Ahead Regular Dividend Growth, Demand Supply Ratio, Utilization and Short Interest, along with a momentum indicator, namely 39-Week Return with 4-week Lag.

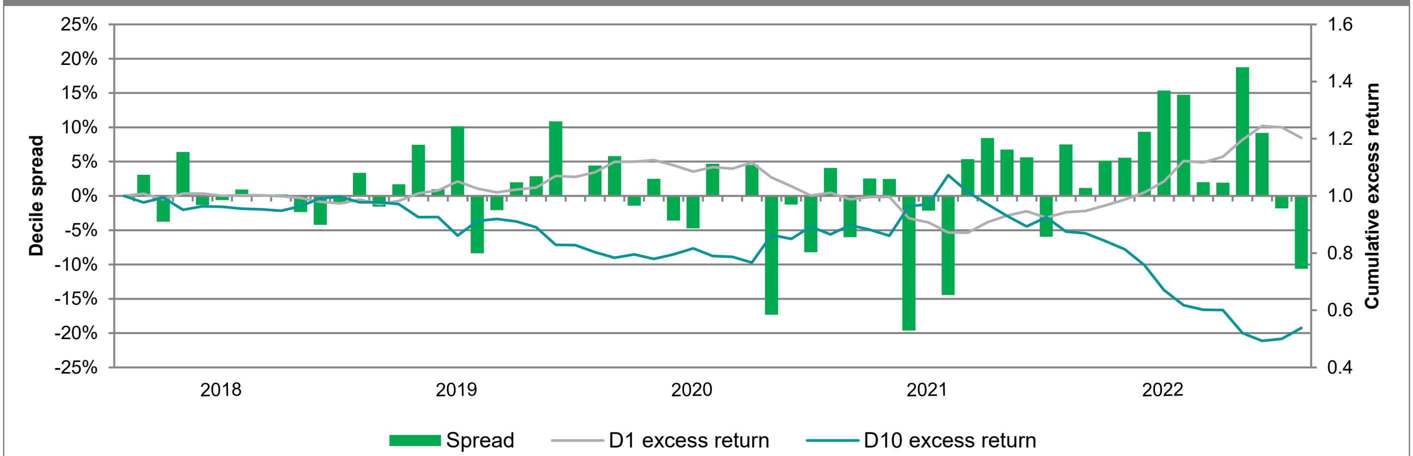
We report monthly decile spreads, calculated as the difference in average returns of the top decile (D1) and bottom decile (D10) names, along with cumulative excess returns at the two tails. Decile results are presented over the past five years for the US Total Cap (Figure 8), Developed Europe (Figure 9) and Developed Pacific (Figure 10) universes.

For the duration of the backtest, the dividend forecast/short sentiment strategy performance was strong, with an average spread of 1.25%. However, results were especially robust since the beginning of 2021, with the average spread reaching 4.42% and a hit rate (percent of months with positive spreads) of 79%. Over the same period, the cumulative D1 excess return outpaced D10 by a sizable 77 percentage points.

In Developed Europe, the performance displayed more consistency, with an average spread of 1.34% and hit rate of 65% over the five-year period. D1 also maintained a consistent cumulative lead over D10 throughout (with one exception at the start of the backtest), expanded by results since 2021. Similar performance was posted for Developed Pacific, with a five-year average spread of 0.93% and hit rate of 63%, accentuated by particular success since 2021.

Figure 8

US Total Cap Dividend + Short Sentiment strategy

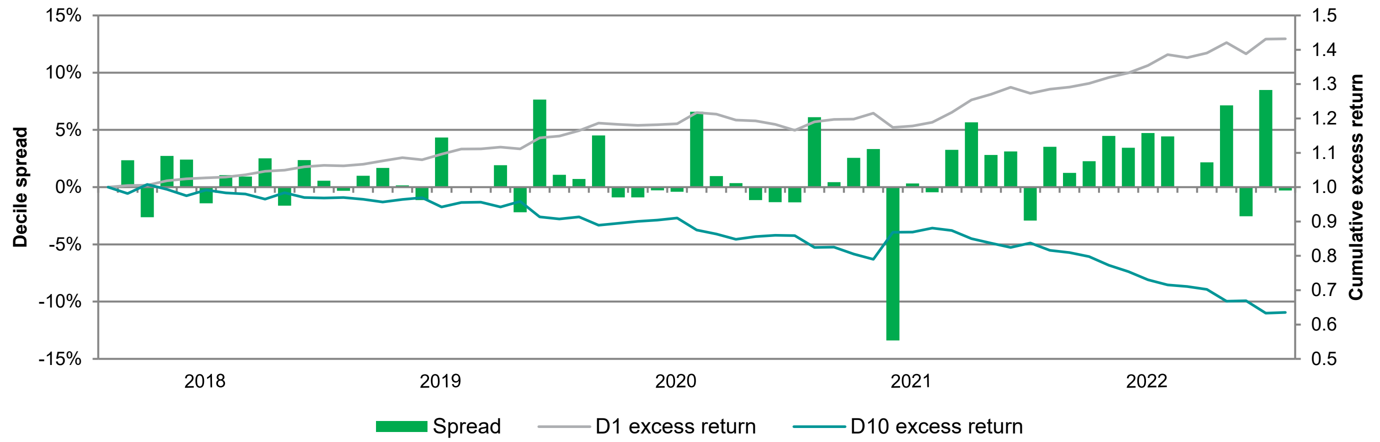


Source: IHS Markit

© 2022 IHS Markit

Figure 9

Developed Europe Dividend + Short Sentiment strategy

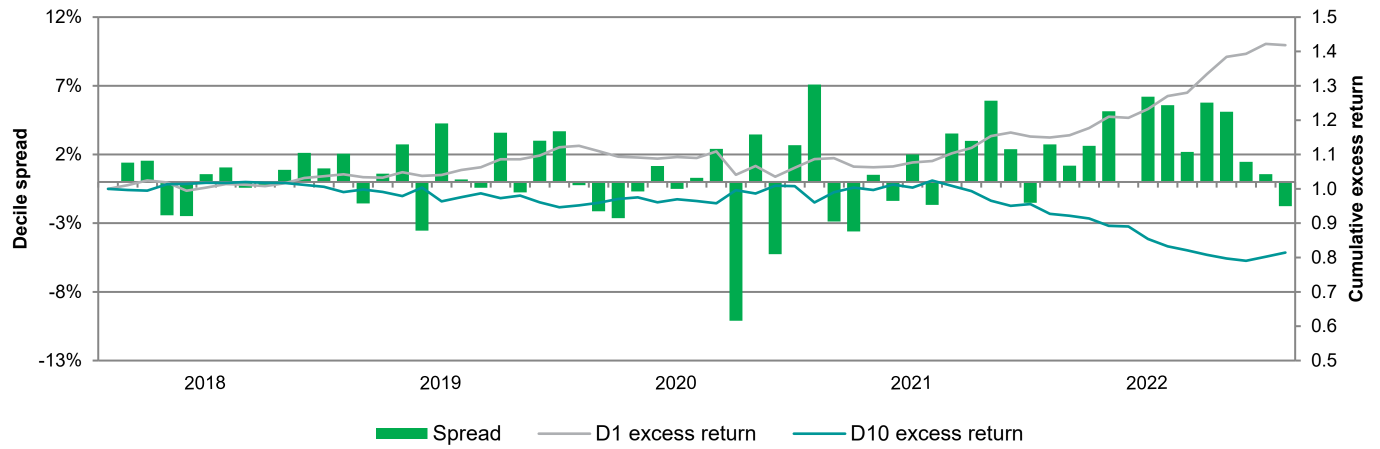


Source: IHS Markit

© 2022 IHS Markit

Figure 10

Developed Pacific Dividend + Short Sentiment strategy



Source: IHS Markit

© 2022 IHS Markit

The fundamentals of dividend's resurgence

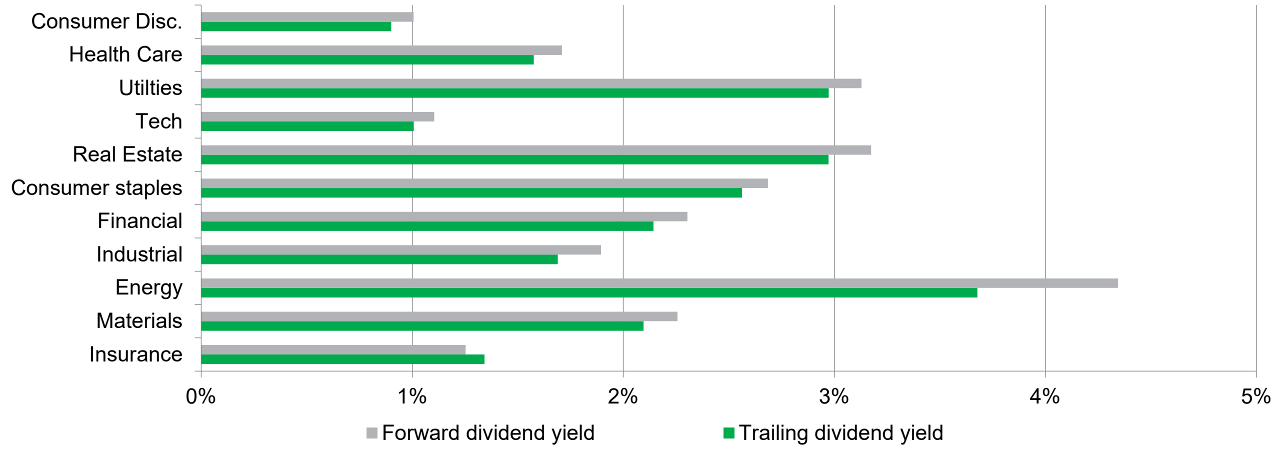
We round out our review with a fundamental assessment of recent trends in dividend factor performance.

Screener results in outperforming sectors

Outperformance of the Leading 12-month Total Dividend Yield factor is the result of selection into quality companies found in industries least impacted by the current economic headwinds. Dividend payments made by these companies are still rebounding, as many emerged from the pandemic with robust sales, greater liquidity and an eagerness to reward patient shareholders. Broadly speaking, strong earnings and healthy balance sheets in select industries have allowed for dividends to re-emerge to prominence in capital plans (Figure 11). Therefore, higher forward yield figures are the result of positive dividend expectations rather than just share price deterioration, resulting in a pool of stable and profitable companies drawn into the model (Figure 12). Higher forward yields versus trailing yields across many industries reflect this outlook.

Figure 11

Forward and trailing yield by industry, U.S.

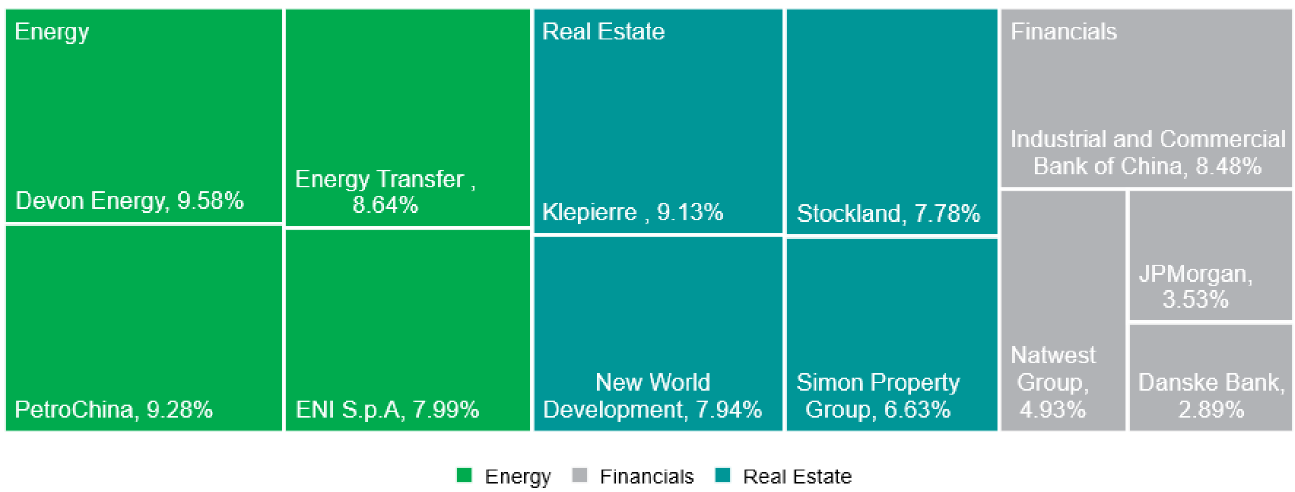


Source: S&P Global

© 2022 S&P Global

Figure 12

High forward yield companies, Global



Source: S&P Global

© 2022 S&P global

For the US region, energy is likely the best example as it is the only sector with positive price growth year-to-date (YTD). Of the 156 companies selected by the Stock Screener for the US, 45 were in the energy sector. While high energy prices are burdening consumers and fueling inflation, energy producers are flourishing and are expected to pay 33% more in dividends this year than in 2021, inclusive of special and variable payments. The industry has paid down significant portions of debt and is limiting capital expenditures. Between cash saved on debt servicing and a lack of expensive investments, income available to shareholders has ballooned. **Devon Energy (DVN)**, an oil exploration and production company, is nearing a zero net debt position and is forecast to pay three times more in 2022 than 2021 for a yield of nearly 10%. **Energy Transfer LP (ET)**, a natural gas pipeline operator, realized 2022 Q1 revenue that was 76% higher than the same period of 2020, in the early stages of the pandemic downturn. It is forecast to increase the annual payout by 27% for a forward yield of 7%. Devon Energy and Energy Transfer stocks are up 27% and 22% YTD, respectively.

In Europe, greater prominence was seen in the Financials industry where 36 of 92 stocks selected were in the sector. European banks, such as **Danske Bank (DANSKE)** of Denmark and **Natwest Group (NWG)** of the United Kingdom, have shown some improvement. Share prices fell in 2020 as dividend cuts were made but are now above those lows since payments were reinstated. European banks are also repurchasing shares like US counterparts, which can act as a buffer during times of reduced capital spending. Further, higher policy rates driven by euro-area inflation near 9% will act as a tailwind to banking net interest margins (NIMs). As banks realize higher rates on loans (while continuing to pay low rates on customer deposits) margins will expand to support profitability and dividend payment. Reserve buildup and strong capital levels will act as a defense against non-performing loans should recession hit. Also, within Financials, insurance companies are paying attractive dividends. **Axa Sa (AXAF)** has a near 8% forward yield, which our team deems sustainable going forward.

Notably, for all three regions there were no Technology or Healthcare companies selected - two of the worst performing sectors of 2022.

The shift into dividend-yielding value

Investor preference in dividend stocks, as supported by the Forward Dividend Yield relationship with the Lending Supply factor, may have to do with a trend-within-the-trend in the shift to value. Value stocks gain prominence during market downturns; however, the category can be characterized in multiple ways.

There is no strict definition of value stocks that require them to pay a dividend. A value stock can be deemed as such because it has attractive pricing metrics (such as price-to-book value) relative to a similar asset. This method of relative value selection is likely in lesser demand, as it would lead to names that have seen their share prices collapse. Instead, investors are turning to the yield-seeking side of value investing, as supported by inflows into SPDR S&P Global Dividend Aristocrats.

Inflation and global recession fears are behind the trend. With the US and Eurozone inflation forecast between 7.5 to 8% for 2022, dividend stocks provide much needed yield to protect against asset erosion. While the S&P Global Markit Intelligence Economics team forecast global GDP to grow 2.7% in 2022 and 2.6% in 2023, some markets, specifically Western Europe, are headed toward a contraction. Dividend paying companies have defensive characteristics that are well suited for recession, supply chain resilience and rising interest rates.

One of these characteristics is a healthy balance sheet that has been enhanced through debt repayment and refinancing done over the prior two years. A favorable interest-rate environment allowed companies to refinance into lower rates and push out maturities. In the US, speculative-grade corporate debt due in 2028 rose by 400% while debt due in 2025 and before dropped considerably, shoring up the risk of severe capital loss.

Many dividend payers also have ample liquidity, significant cash flow generation, and an ability to maintain margins in a rising cost environment. **A.P. Moller Maersk (MAERSK B)** grew free cash flow to $6 billion in the first quarter from $2.35 billion in the same period of 2021 as it used strong demand to pass along higher costs. The shipping company signed 80% of its contracts at $1,400 premium per container versus prices received in 2021, allowing for a dividend payment 7.6 times higher than that of last year. **The Coca-Cola Company (KO)** took a more conservative approach, increasing its annual payout by 5% despite consistent revenue growth and rock-solid margins above 60%. In each case, it is clear why investor demand for these businesses would be sought out in a flight to safety.

Summary

Global dividend payments have surged in the first half of the year, with aggregate payments up 13% as compared to the first half of 2021, and our Dividend Forecasting team expects global aggregate dividends to increase by a total of 6.5% in 2022. By region, dividends are expected to grow 4% in Europe, 10% in America and 6.6% in the APAC region, led by Banks and Energy industries, with retail and institutional investor money following this strategy.

The highest dividend yield firms outperformed non-dividend payers by notable spreads in the US Total Cap (39.6 percentage points), Developed Europe (29.7 percentage points) and Developed Pacific (26.9 percentage points) universes over the past year. Taking advantage of this dividend yield strategy, which also outpaced its earnings estimate-based value cohort in 2022 in each region, we construct a dividend forecast/short sentiment multi-factor model which demonstrated robust performance since the beginning of 2021, with average decile spreads of 4.42%, 2.66% and 2.55%, respectively.

Firms which passed our screen for attractive forecasted dividend yield include US-based Devon Energy and Energy Transfer LP, Danske Bank of Denmark and Natwest Group of the United Kingdom, while no Technology or Healthcare companies were selected. Many dividend payers also have ample liquidity, significant cash flow generation and an ability to maintain margins in a rising cost environment, including Danish shipping company A.P. Moller Maersk and American multinational beverage corporation The Coca-Cola Company.

Customer Care

CustomerCare@ihsmarkit.com

Asia and the Pacific Rim

Japan: +81 3 6262 1887

Asia Pacific: +604 291 3600

Europe, Middle East, and Africa: +44 1344 328 300

Americas: +1 800 447 2273

IHS Markit®

now a part of

S&P Global