

Forecast dividend yield strategy outperforms— Hong Kong SAR

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Executive summary

- Using S&P Global Market Intelligence estimates, dividend factors constructed based on high forecast dividend yield (HFDY) outperforms Hong Kong SAR's benchmark³ by 2.43% annualized over the past decade. HFDY is also better versus trailing dividend yield metrics (HTDY) by 0.67% annualized over the same period.
- HFDY presents better risk-adjusted return at 21.80% (Sharpe Ratio 10 years) and 27.63% (Sortino Ratio 10 years), compared with 16.98% and 21.70% for HTDY.
- Over the past decade, forecast dividend yield proved to be a defensive cushion of share price drops with a higher information coefficient (IC)⁴ during bear months.
- HFDY provides exposure to typical high-yielding sectors. Over the past 10 years, the top sector—Financials—had an average exposure of 36.1%, representing a 10.6% active exposure compared with the benchmark. Compared with yield strategies, dividend factor constructed based on high forecast dividend growth (HFDG) exhibits better sector diversification, but underperforms overall.
- Dividend Forecasting service, supported by fundamental bottom-up approach adds key values to generating more meaningful dividend yields in forward-looking trading strategies, based on our case studies.

Traditionally, dividend factors are calculated using trailing dividend yields, overlooking the everchanging market conditions, revisions to dividend policies and company-specific turnarounds. However, our forecast dividends incorporate fundamental analysis that identifies companies with more attractive yields and the sustainability of their dividends—capacity to keep paying instead of suspending future dividends. This would have been a different outlook for trailing dividend yields—where there would be a substantial proportion of yield traps within the stock universe as dividends used in trailing dividend yields are not adjusted by analysts after share prices plummet.⁵

S&P Global Market Intelligence has used historical dividend forecasting records from August 2012 until present to test two forecast dividend factors and their performance—Leading 12 Month Regular Dividend Yield (HFDY), which is defined as forecast regular dividend payment over next year divided by current stock price, and One-Year Percentage Growth in Regular Dividend (HFDG), which is defined as percentage growth of forecast regular dividends over next year versus the actual dividends over previous year. To compare, we have another factor—TTM Dividend Yield (HTDY), which is defined as the trailing 12-month dividends per share for a stock dividend by its trading price. We focus on one of the most active dividend-paying markets: Hong Kong SAR.

¹ Historical dividend forecasting records are from S&P Global Market Intelligence Dividend Forecasting database. Factor-related and performance calculations are from S&P Global Research Signals platform using historical dividend forecasting records.

² Carlos Garcia-Lastra Marques, CFA, Principal Research Analyst; Mohammad Hassan, CFA, Product Analysis and Design Associate Director; Maojun Ye, CFA, Product Analysis and Design Associate Director also contributed to this report.

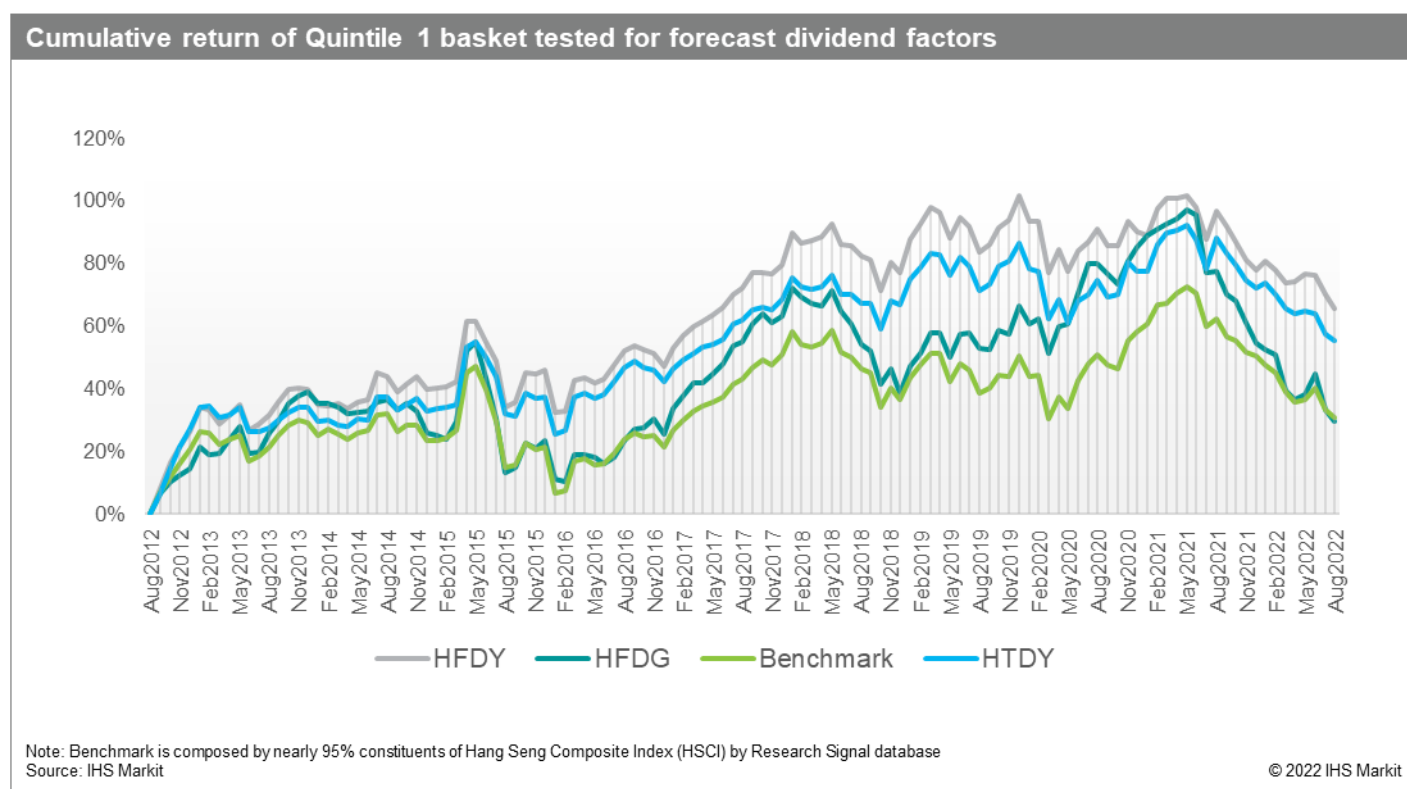
³ The benchmark is composed by nearly 95% constituents of Hang Seng Composite Index (HSCI) by Research Signal database.

⁴ Definition: IC is calculated as percentile rank correlation of the respective factor with the return of any given universe by Research Signals.

Selection methodology

We have measured the predictive power of these forecast dividend factors for future equity returns by applying both information coefficient (IC) analysis using a one month holding period and quintile return analysis. To further measure the performance of each factor, we have also back-tested the Top 20% baskets (Quintile 1) ranked by above mentioned factors over the last decade with an equal weighting methodology applying monthly rebalances from a broad universe of Hong Kong all cap companies (Benchmark).

Baskets of Hong Kong universe using S&P Global Market Intelligence Dividend Forecasts data outperformed the Hong Kong broad market from 2012 to date.



Selecting stocks with high forecast dividend yields, using S&P Global Market Intelligence estimates, resulted in an average 27.2% outperformance compared to the benchmark. Back-testing results since August 2012 indicate that HFDY rose 709.7% versus 354.4% for the benchmark.

HFDY outperforms with an average excess return of 8.8%, compared with HTDY. Taking the full period analyzed since August 2012 until present for Hong Kong, the cumulative return for HFDY was higher than that of HTDY for 115 out of 121 months in the whole sample, presenting a winning chance of 95.0

Annualized return of Quintile 1 basket tested for forecast dividend factors

	HFDY	HTDY	HFDG	Benchmark
10 year annualized return	5.16%	4.48%	2.62%	2.72%
1 year annualized return	-11.76%	-12.94%	-26.75%	-18.02%
10 year annualized St Dev	12.19%	11.69%	14.65%	13.34%
10 year Sortino Ratio*	0.28	0.22	0.01	0.02
10 year Downside Risk	9.62%	9.14%	11.83%	11.06%
10 year Sharpe Ratio	0.22	0.17	0.01	0.02

Notes: *Risk-free return is set as 2.5% based on the 10 year CN T-Note

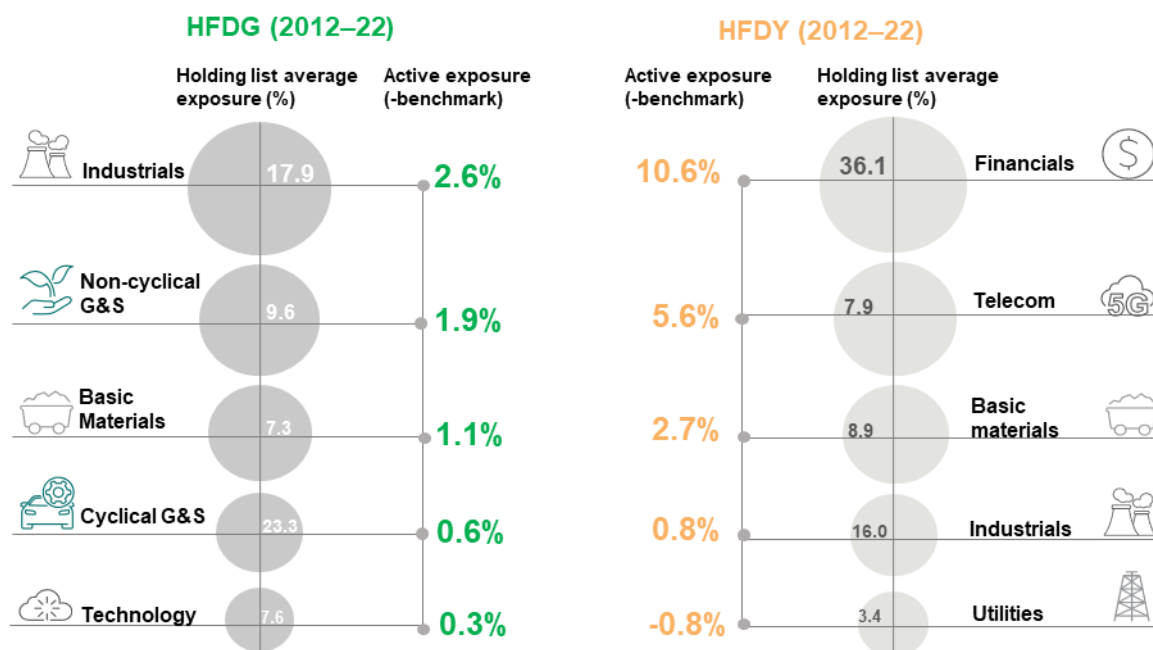
Source: IHS Markit

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In terms of annualized return, HFDY outperforms the benchmark by 2.43% over the past decade with less volatility, by 1.15%. Considering the downside risk solely, HFDY is less volatile at 9.62%, compared with 11.06% for benchmark.

HFDY outperforms HTDY by 0.67% annualized over the past decade with more volatility. However, the risk-adjusted return is much better at 21.80% (Sharpe Ratio 10 year) and 27.63% (Sortino Ratio 10 year), compared with 16.98% and 21.70% for HTDY, indicating higher additional return for each unit of downside risk taken. Incorporating dividend estimates provides us more up-to-date market changes of payout policies, upcoming decisions pertaining shareholder remuneration, and future earnings performance. Removing stocks that could potentially decrease dividends owing to an anticipated deterioration in earnings or adding stocks that are likely to instigate dividend distribution is a superior approach that creates value in the long term.

Sector Exposure Comparable between HFDY and HFDG from 2012 to date



Source: IHS Markit

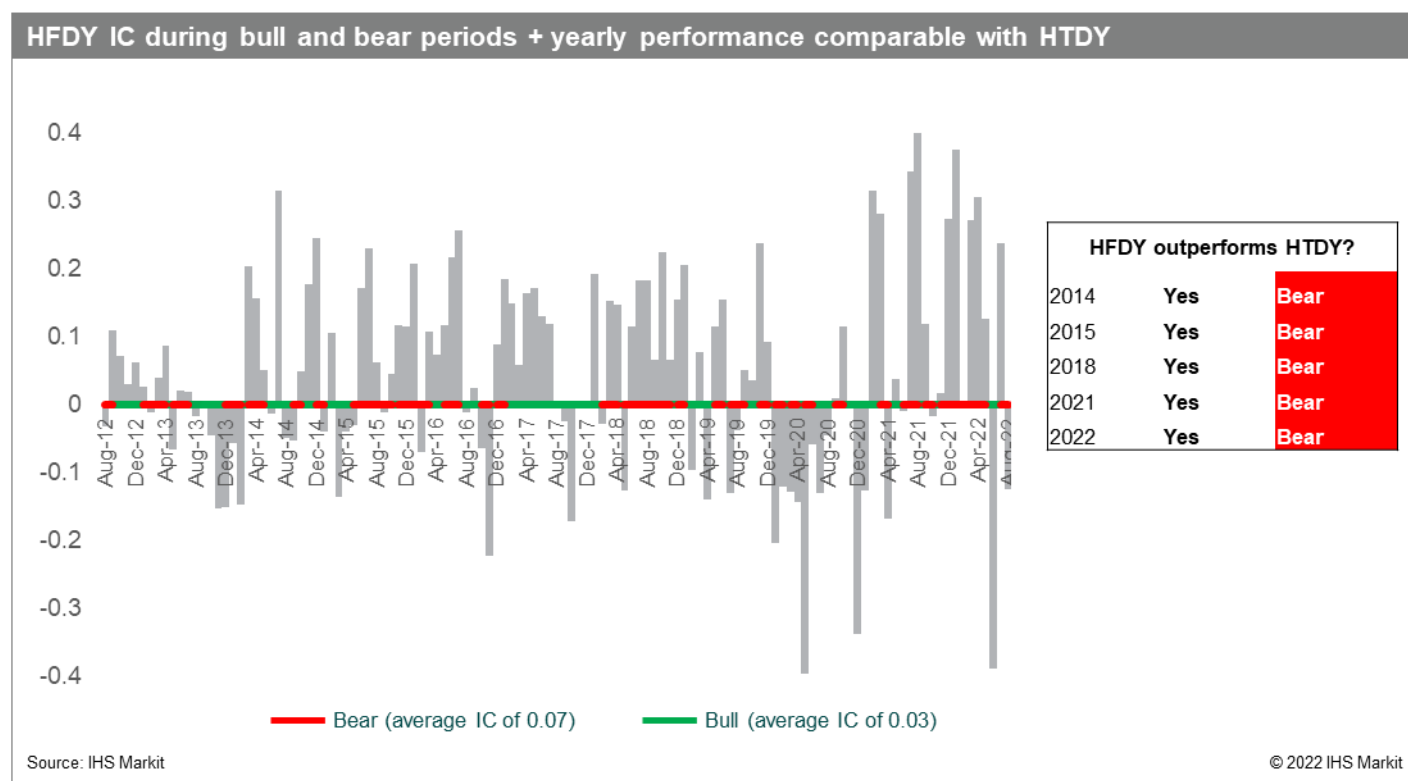
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The HFDY basket, constructed with an equal weighting methodology, provides exposure to typically high yielding sectors such as Financials, Basic Materials, and Utilities, which tend to have more attractive dividend policies compared with other sectors. During the 10-year back-testing period, the top holding sector—Financials—has an average exposure of 36.1%, with an active exposure of 10.6% higher than the benchmark. In

the past two years, Energy replaced Utilities in the top five, mainly attributable to its attractive forward yield valuations given soaring oil demand/price under uncertain geopolitics environment.

Unlike the pure yield strategy, HFDG tends to be more diversified across sectors. Sector diversification could possibly help if there were large moves in performance in particular sectors as an overall market stays in a growth regime. Technology, not a conventionally high-dividend paying sector, is identified as one of the top five sectors given skyrocketing expected dividend growth rate. However, during the back-testing periods for Hong Kong universe, HFDG underperformed over HFDY overall with a significant level of volatility, possibly owing to some market specific momentum interference captured into the basket. The influence of state-led development of stock market may have contributed to a positive return premium on conventionally high-dividend paying sectors like Financials, Utilities, and Energy in recent years, which are included mostly in HFDY basket not HFDG basket. The lingering perception of the state influence, particularly from the “National Team” (a nickname for the collection of state-related bodies that Chinese authorities lean on to buy stocks during times of turbulence established long before the 2015 crisis⁵) may distort the price discovery process and fuel up those high-dividend paying sectors which are heavily weighted by the state-owned companies. These stocks are usually picked up by the HFDY basket not HFDG basket as well.

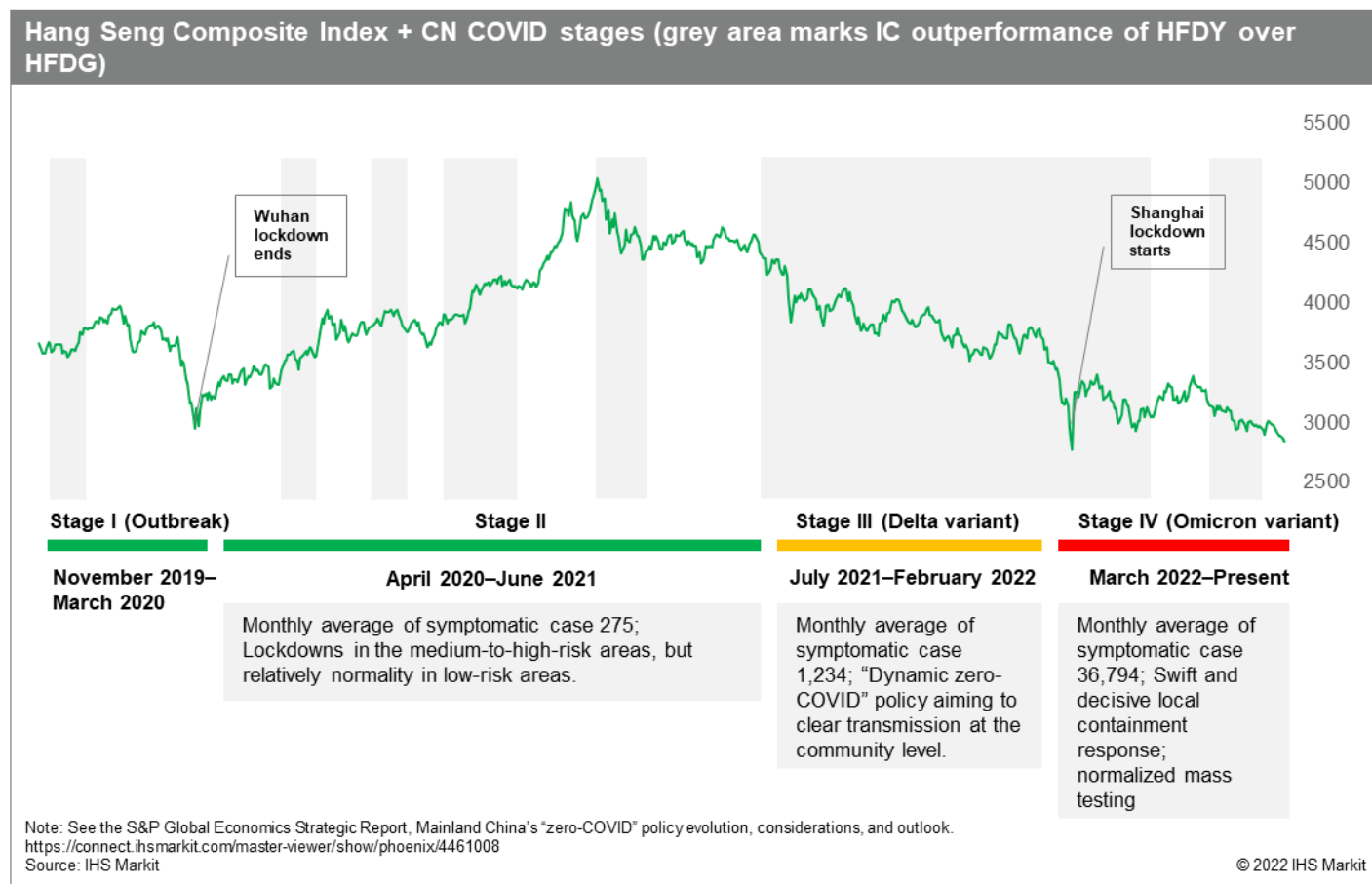
Forecast dividend yield—A defensive cushion during price downturns



HFDY serves a better cushion during price downturns, as shown by the average information coefficient (IC) during bear months outperforms the average IC during bull months by 0.04 since August 2012 to date. Taking the full period analyzed since the August of 2012 until present for Hong Kong, the IC for HFDY was positive for 34

⁵ https://www.washingtonpost.com/business/when-stocks-crash-china-turns-to-its-national-team/2022/03/15/bd4d319e-a4d8-11ec-8628-3da4fa8f8714_story.html

out of 54 bear months in the whole sample, presenting a winning chance of 62.9%. Furthermore, the annual return for HFDY was higher than that of HTDY for five out of five bear years in the whole sample periods.

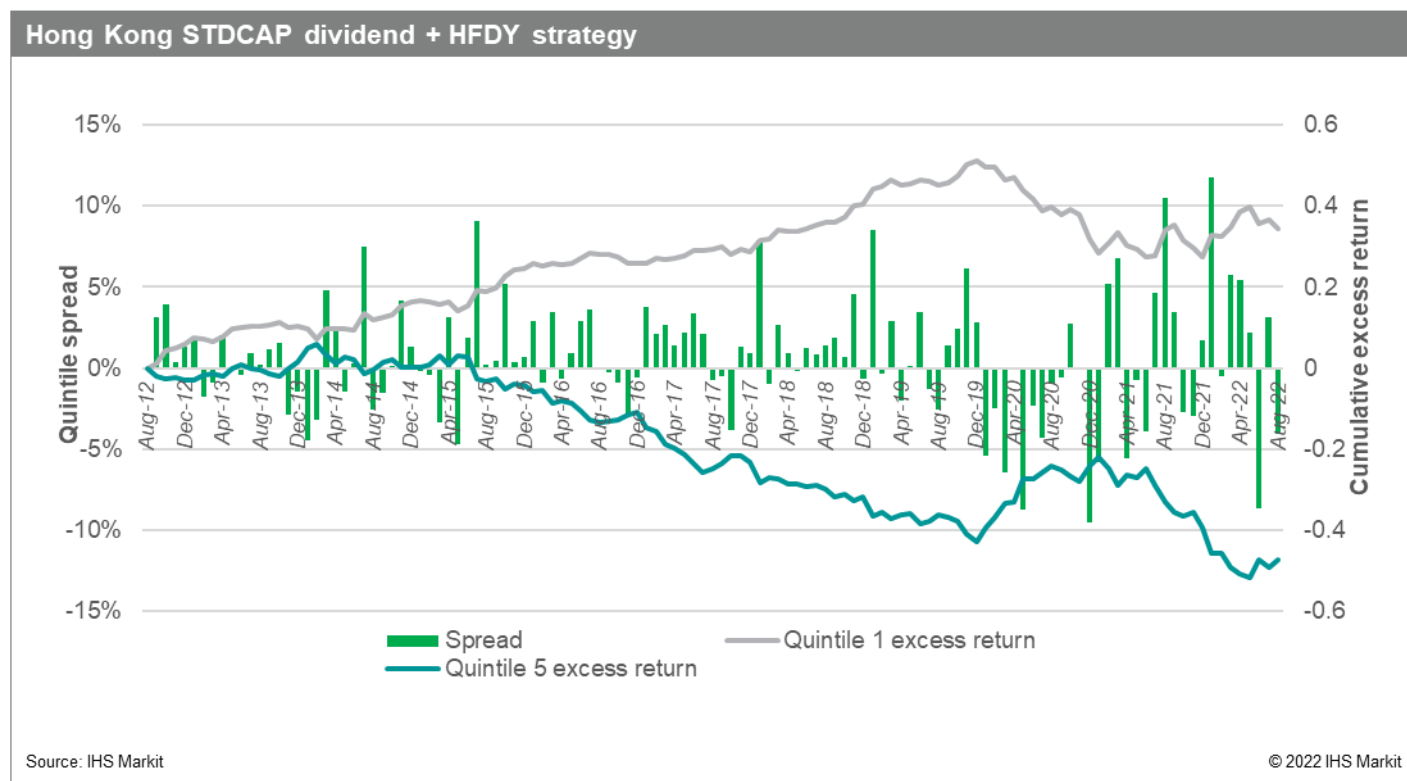


In our previous factor research on markets such as Canada, Japan, and the United States, HFDG on average tended to outperform HFDY during market rally conditions. But shortly after the outbreak of COVID-19 pandemic in the first quarter of 2020, HFDY surpassed HFDG in the IC analysis.

In comparison, we observed a time lag for HFDY strategy/basket to beat HFDG in Hong Kong. The inferior performance of HFDY lasted from the beginning of the pandemic (early 2020) with negative ICs, until it finally made a turnaround in the later half of 2021 when HSCI tumbled with the worsening COVID situation and tightening control. During this period, the IC of forecast dividend yield not only turned positive but also reached as high as 0.4—indicating a remarkably stronger correlation between forecast dividend yield and forward equity returns than any other testing period over the past decade.

Hong Kong index performance was not spared from the Wuhan outbreak, with maximum drawdown of Hang Seng Composite Index by nearly 74.8% until late March 2020. However, from April 2020 to June 2021 (Stage II), economic activities were still not severely affected owing to relatively normality in low-risk areas. Therefore, the index price climbed steadily when HFDG outperformed HFDY mostly. From July 2021 to present (Stage III, Stage IV), market uncertainties poured pressure on corporate earnings due to the “Zero-COVID” policy and decisive local containment responses that followed. With that, HFDY outperformed HFDG in 12 out of 14 months applying IC analysis, presenting a winning chance of 85.7%. Stocks with forecast dividend yield analyzed based on fundamental research could present a compelling investment opportunity under such extreme conditions. An allocation to companies that are expected to hold attractive dividend yields may address the risk of return

drawdown. On the converse, stocks with sluggish forecast dividend yields could merit further scrutiny for the ‘short’ side of the trading book.



Taking reference of the monthly quintile spreads for the duration of back-testing, calculated as the difference in average returns of top Quintile 1 and bottom Quintile 5 names, along with cumulative excess returns at the two tails, HFDY was relatively strong with an average spread of 0.67%. However, results were especially robust since the beginning of 2021, with the average spread reaching 1.65% and a hit rate (percent of months with positive spreads) of 65%. Over the same period, cumulative Quintile 1 excess return outpaced Quintile 5 by a sizable 71 percentage points.

Fundamental bottom-up approach is a key differentiator

Case study of exposure variance across HFDY vs HTDY baskets in the past year

Since the first half of 2022, the HFDY basket has increased its advantage over the HTDY basket by increasing exposure of the Energy sector. Looking at an example from individual stocks, the performance of HTDY basket was mainly underpinned by **CNOOC (ISIN: HK0883013259)**, which was deleted in the first month of 2022 owing to a lower trailing dividend yield of 5.9% on the rise of stock price. However, our analysts projected a nearly doubled dividend, resulting in a forward yield of 11.1% at that point of time. The stock has soared nearly 47.3% until to date since the beginning of 2022, which adds excess return to the HFDY basket. CNOOC announced its FY 2022's interim dividend as HK\$0.7, representing a 133.3% year-on-year growth in line with our analyst's estimation.

Case study: Energy exposure variance across forward and trailing dividend yield baskets (2021–22)

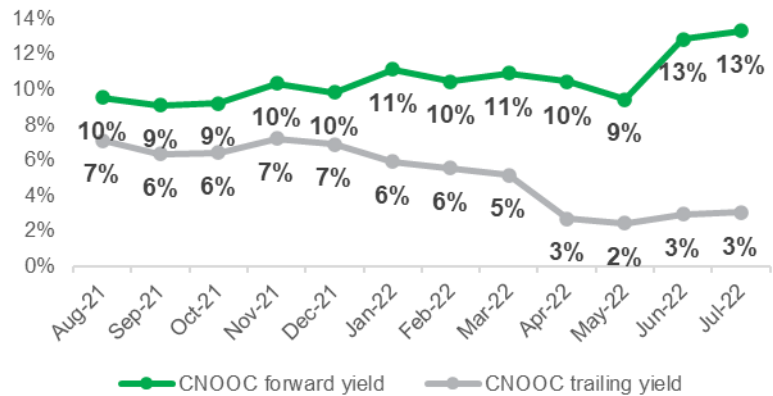
Holding average exposure (%)

2.9

HFDY

2.2

HTDY



Source: IHS Markit

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Case study: Financials exposure variance across forward and trailing dividend yield baskets (2021–22)

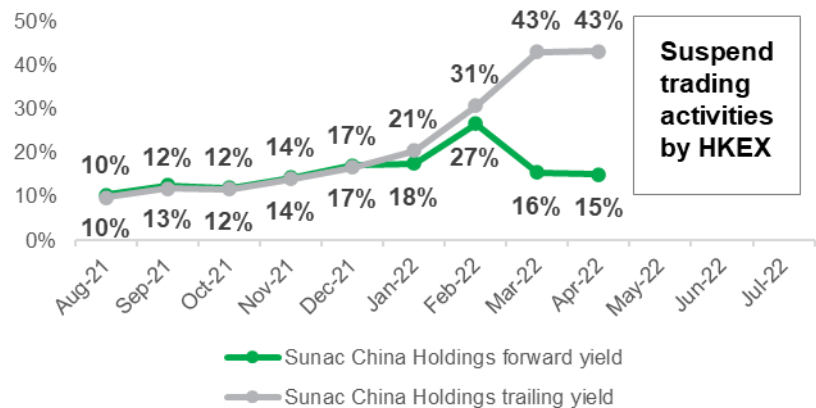
Holding average exposure (%)

38.4

HFDY

47.9

HTDY



Source: IHS Markit

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On the other hand, stocks contributing to the HTDY basket underperformance include one example from the subgroup Real Estate under the Financials⁶ sector. **Sunac China Holdings (KYG8569A1067)**, which was kept in the trailing basket for the whole time with its trailing yield reaching nearly 43.2% since March 2022 due to bottom-hit stock price under the market worrisome for indebted property giants. However, our analysts forecast a dividend cut resulting forward yield drop to 15.6% at the same period of time and therefore excluded this stock from the forecast factor basket. The stock dropped by 79.1% until April 2022 as the company claimed to default

⁶ Financials contains Real Estate, Banks, Insurance and Diversified Financial Services, as classified by Research Signals.

on several due notes or within the relevant grace periods. The stock was further suspended by HKEX in trading activities since April this year. With fundamental analysis of Hong Kong stocks at risk in Real Estate sector, HFDY basket avoided losses compared to HTDY basket.

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