

DON'T COUNT YOUR DIVIDEND CHICKENS

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Investors can normally rely on the stability of [dividends](#). A company cutting its dividend is typically a significant negative signal in U.S. markets, making cuts rare among the largest dividend payers. In times of stress, companies tend to cut [share buybacks](#) first, which are viewed by investors as more discretionary, before touching dividend payouts.

But 2020 has been far from normal times.

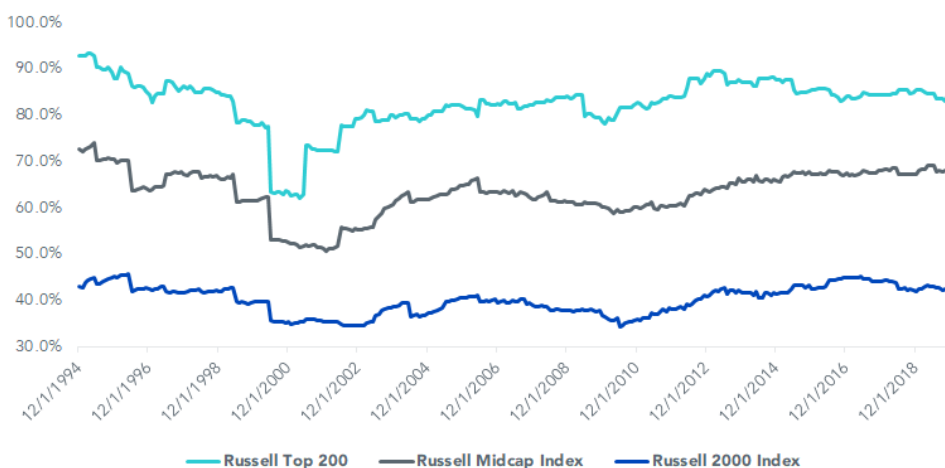
And within [mid-](#) and [small-cap](#) companies, the picture for dividend cuts has been more challenged than for [large-cap](#) companies. Investors would be remiss to count their dividends before they are paid out.

Who Pays Dividends

This trend of smaller companies more significantly slashing payouts isn't surprising. During an economic slowdown, smaller companies usually have less credit access to sustain cash flows and thinner profit margins, making them relatively more burdened by a sales slowdown.

The number of mid- and small-cap dividend payers had been increasing in the years since the financial crisis. The nearly 70% of companies in the [Russell Midcap Index](#) that paid dividends was nearly a 20-year high. This means there was a healthy and diverse base of companies paying out dividends before cuts began—particularly for mid-caps.

Percent Constituents Dividend-Payers



Sources: WisdomTree, FactSet, 12/31/1994–12/31/2019. Past performance is not indicative of future results. You cannot invest directly in an index.

The mid- and small-cap sectors that pay out the most in dividends are Financials and Real Estate, making up a disproportionate amount of the [Dividend Stream](#)[®] weight. In the Russell Top 200, Information Technology is the largest dividend-paying sector but accounts for only about 17% of the weight. This is much smaller than the 33% that comes from Financials alone in the Russell 2000.

In mid- and small caps, few dividends come from the growthiest sectors that have held up the best during the pandemic.

This has hurt strategies that favor the more value-tilted, dividend-paying sectors in mid- and small caps relatively more than similar strategies focused on large caps.

Russell Midcap Index			
Sectors	Dividend Stream Weight	Market-Cap Weight	Over / Under Weight
Real Estate	19.75%	8.66%	11.08%
Financials	20.21%	12.49%	7.72%
Utilities	11.29%	6.24%	5.05%
Energy	6.58%	3.75%	2.83%
Consumer Staples	5.59%	4.93%	0.66%
Materials	5.38%	4.84%	0.54%
Consumer Discretionary	9.20%	11.14%	-1.95%
Industrials	9.55%	13.53%	-3.99%
Communication Services	2.65%	6.86%	-4.22%
Health Care	2.15%	9.76%	-7.61%
Information Technology	7.67%	17.79%	-10.12%

Russell 2000 Index			
Sectors	Dividend Stream Weight	Market-Cap Weight	Over / Under Weight
Real Estate	25.06%	7.23%	17.83%
Financials	32.71%	17.29%	15.42%
Utilities	6.81%	3.43%	3.38%
Energy	4.01%	3.55%	0.46%
Materials	4.19%	3.90%	0.28%
Communication Services	2.38%	2.75%	-0.37%
Consumer Staples	2.89%	3.38%	-0.49%
Consumer Discretionary	7.92%	10.62%	-2.70%
Industrials	9.63%	15.19%	-5.56%
Information Technology	3.53%	12.99%	-9.47%
Health Care	0.89%	19.67%	-18.78%

Sources: WisdomTree, FactSet, as of 12/31/19. You cannot invest directly in an index.

The best-performing sectors in 2020 have been those more resilient to work-from-home trends (Information Technology) and those typically more defensive (Health Care). The worst-performing have been more cyclically oriented [value](#) sectors like Energy, Financials and Industrials.

S&P 1500 Index		
2/19/20—3/23/20 (Peak to Trough)	3/23/20—5/19/20 (Recovery)	12/31/19—5/19/20 (Year-to-Date)
-23.97% - Cons. Staples	59.33% - Energy	3.54% - Info. Tech.
-28.32% - Health Care	37.64% - Cons. Disc.	-1.21% - Health Care
-28.67% - Comm. Svc.	37.33% - Materials	-3.19% - Comm. Svc.
-31.46% - Info. Tech.	35.52% - Info. Tech.	-3.35% - Cons. Disc.
-33.67% - Cons. Disc.	34.54% - Health Care	-8.51% - Cons. Staples
-34.47% - S&P 1500	31.20% - S&P 1500	-9.95% - S&P 1500
-35.62% - Utilities	28.70% - Industrials	-13.24% - Utilities
-36.92% - Materials	27.43% - Comm. Svc.	-15.08% - Materials
-39.98% - Real Estate	25.13% - Real Estate	-20.58% - Real Estate
-41.72% - Industrials	24.65% - Utilities	-22.83% - Industrials
-43.18% - Financials	22.24% - Financials	-29.73% - Financials
-56.29% - Energy	17.67% - Cons. Staples	-37.15% - Energy

Sources: WisdomTree, Bloomberg. You cannot invest directly in an index. Past performance is not indicative of future returns.

Market Prices Following Dividends

This year’s underperformance of mid- and small caps relative to large caps can in some ways be traced to what is happening to dividends.

Take a quote from a recent note from Morgan Stanley Research:

[i]n an era of sound bites and headlines, it's easy to forget why one really owns stocks -i.e. for the future claims on excess cash flows to be distributed to shareholders. In short, the current price of a stock should reflect the discounted value of future dividends to the equity stakeholder.¹

While the [WisdomTree U.S. LargeCap Dividend Index](#) has shed under 3% from its indicated *Dividend Stream* in 2020, the mid- and small-cap dividend indexes have seen cuts of 17%–24%. And while some sectors in the large-cap index have actually seen notable dividend growth—primarily Health Care, Utilities, Materials and Tech—cuts have been widespread across sectors in smaller market caps.

Dividend Stream Growth from November 30, 2019 (Latest Index [Rebalance](#))

WTMDI Dividend Stream Growth Rate			WTSDI Dividend Stream Growth Rate		
Sector	3/13/20	5/14/20	Sector	3/13/20	5/14/20
Communication Services	8.11%	-12.22%	Communication Services	-13.26%	-44.82%
Consumer Discretionary	0.35%	-53.65%	Consumer Discretionary	3.54%	-55.99%
Consumer Staples	0.98%	-14.95%	Consumer Staples	-2.73%	-7.64%
Energy	-4.53%	-55.50%	Energy	-3.23%	-36.00%
Financials	3.96%	2.32%	Financials	3.19%	-4.21%
Health Care	0.59%	-13.40%	Health Care	0.98%	-5.80%
Industrials	2.89%	-13.83%	Industrials	2.16%	-20.96%
Information Technology	2.13%	-6.69%	Information Technology	1.97%	-8.92%
Materials	1.91%	-5.42%	Materials	-1.30%	-14.61%
Real Estate	-0.41%	-19.03%	Real Estate	-1.75%	-35.96%
Utilities	7.58%	2.19%	Utilities	-16.09%	-15.73%
Total	1.73%	-17.46%	Total	-0.43%	-23.73%

Sources: WisdomTree, Bloomberg, as of 5/14/20. March 13, 2020 represents an unofficial peak dividends date. You cannot invest directly in an index. WTMDI = WisdomTree U.S. MidCap Dividend Index. WTSDI = WisdomTree U.S. SmallCap Dividend Index.

With the backdrop of dividends under acute pressure for mid- and small-cap companies, the question then becomes how much of the negative is already baked into market prices.

Trailing total shareholder yields of greater than 5% for the [WisdomTree U.S. MidCap Dividend Index \(WTMDI\)](#) and the [WisdomTree U.S. SmallCap Dividend Index \(WTSDI\)](#) are an imperfect reflection on what investors should expect going forward. However, on a

relative basis to the broad market cap-weighted, value and growth benchmarks, they offer significant yield premiums.

On a normalized price-to-earnings basis, the mid- and small-cap dividend indexes are at the sixth and fifth percentiles relative to their histories. This compares to the S&P 500 Index, which is trading at a 21x normalized P/E ratio—this is the 78th percentile over the same period.

Fundamental	Mid-Caps				Small Caps			
	WTMDI	RUMIDCAP	RMIDVL	RMIDGR	WTSDI	RU2000	RU2000V	RU2000G
Dividend Yield	4.31%	2.01%	2.98%	0.78%	5.62%	1.75%	2.90%	0.82%
Net Buyback Yield	1.47%	1.27%	1.24%	1.32%	-0.28%	-1.34%	-0.51%	-2.02%
Total Shareholder Yield	5.78%	3.28%	4.21%	2.11%	5.34%	0.41%	2.39%	-1.20%
Price/Earnings (Normalized)	12.55	17.88	14.16	28.06	11.51	15.22	11.66	22.68
Percentile P/E vs. History	6.0%	23.5%	16.3%	86.1%	4.8%	6.6%	6.0%	14.5%
Price/Book	1.45	2.33	1.55	6.28	1.25	1.77	1.06	3.83
Percentile P/B vs. History	9.6%	34.3%	30.1%	81.9%	7.8%	14.5%	6.6%	49.4%

Sources: WisdomTree, FactSet. Data as of 4/30/20. Valuations vs. History use monthly observations going back to 6/30/06, the first month-end since the inception of WisdomTree's dividend indexes. Normalized Price/Earnings uses trailing three-year earnings and excludes companies with negative earnings. WTMDI = WisdomTree U.S. MidCap Dividend Index. RUMIDCAP = Russell Midcap Index. RMIDVL = Russell Midcap Value Index. RMIDGR = Russell Midcap Growth Index. WTSDI = WisdomTree U.S. SmallCap Dividend Index. RU2000 = Russell 2000 Index. RU2000V = Russell 2000 Value Index. RU2000G = Russell 2000 Growth Index. You cannot invest directly in an index.

Small Value Premium via Dividend Weighting

WisdomTree's dividend-weighted mid- and small-cap indexes have high loadings to the size and value premiums. This is mainly driven by under-weights to the Information Technology and Health Care companies that pay very little dividends and over-weights to Financials. Relative to the Russell value benchmarks, these indexes have higher loadings to the quality-or profitability-factor. By giving greater weight to companies that pay higher cash dividends, the dividend indexes have an indirect tilt to companies with higher earnings that have a greater ability to pay out more in dividends.

Index	Fama-French Factor Loadings (5/31/06 - 3/31/20)				
	Mkt-RF (Beta)	SMB (Size)	HML (Value)	RMW (Quality)	CMA (Investment)
WisdomTree U.S. MidCap Dividend	1.02	0.26	0.38	0.31	-0.01
Russell Midcap Value	1.04	0.26	0.22	0.11	0.04
WisdomTree U.S. SmallCap Dividend	0.93	0.72	0.49	0.28	0.09
Russell 2000 Value	0.96	0.80	0.35	0.09	0.06

Sources: WisdomTree, FactSet.

For definitions of terms in the table, please visit our [glossary](#).

Preparing for the Reopening

Historically, small value tends to outperform large cap during recoveries—the opposite of what works best during the recession phase. But investors may rightly question being “too early to the party” on a recovery trade.

For strategic asset allocators, a combination of more richly valued, high-quality large-cap stocks may pair well with smaller cap stocks with some of the most depressed valuations in their history. While timing when the payoff will come for small-cap value will be difficult, history suggests the rewards could be significant.

¹Morgan Stanley Research, “Weekly Warm Up: A Pause to Refresh; Dividends Matter,” 5/4/20.

For standardized performance and the most recent month-end performance click [here](#) NOTE, this material is intended for electronic use only. Individuals who intend to print and physically deliver to an investor must print the monthly performance report to accompany this blog.

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DEFINITIONS

Dividend: A portion of corporate profits paid out to shareholders.

Share buybacks: Firms using cash to purchase their own outstanding shares; may positively impact the share price.

Mid-Cap: Characterized by exposure to the next 20% of market capitalization (after the top 70% have been removed) within the Value, Blend or Growth style zones with the majority of the fund's weight.

Small caps: new or relatively young companies that typically have a market capitalization between \$200 million to \$2 billion.

Large-Capitalization (Large-Cap): A term used by the investment community to refer to companies with a market capitalization value of more than \$10 billion. Large cap is an abbreviation of the term "large market capitalization". Market capitalization is calculated by multiplying the number of a company's shares outstanding by its stock price per share.

Russell Midcap Index: The Russell Midcap Index measures the performance of the mid-cap value segment of the U.S. equity universe. It includes those Russell Midcap Index companies with lower price-to-book ratios and lower forecasted growth values.

Dividend Stream: Refers to the regular dividends per share multiplied by the number of shares outstanding.

Value: Characterized by lower price levels relative to fundamentals, such as earnings or dividends. Prices are lower because investors are less certain of the performance of these fundamentals in the future. This term is also related to the Value Factor, which associates these stock characteristics with excess returns vs the market over time.

Rebalance: An index is created by applying a certain set of selection and weighting rules at a certain frequency. WisdomTree rebalances, or re-applies its rules based selection and weighting process on an annual basis.