
HIGH-DIVIDEND STOCKS: A LONELY OPPORTUNITY?

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There is a market “truism” that needs to be set straight. In summary:

“Rising [interest rates](#) hinder high dividend equities.”

We’d rephrase it this way:

“Rising rates have been hindering high-dividend equities in the last couple of years, but over any sizable time frame, the causal relationship between rates and equity factors has been cursory at best.”

With that, see figure 1. It shows the [S&P 500 Growth Index](#) relative to the [WisdomTree U.S. High Dividend Index](#) since the birth of the [WisdomTree U.S. High Dividend Fund \(DHS\)](#) in 2006, along with [10-Year Treasury yields](#). Growth was outperforming big dividend payers in the years immediately preceding the global financial crisis, and it kept leading during the crisis. Throughout the middle of the decade, bond yields gyrated back and forth, ultimately halving. Yet high-dividend payers struggled, defying today’s popular notion that interest rate directionality is the determining factor of dividend stocks’ relative performance.

Growth stocks’ leadership run ended on March 11, 2009, just days after the stock market bottomed, and high-dividend payers began to outperform in the early years of the economic recovery. Despite improving business conditions, bond yields kept falling until 2012. Those three years were among the few that do appear to confirm the popular “truism.”

Figure 1: Interest Rates Are Not Always the Arbiter of Performance



Source: Bloomberg. Data as of 3/12/18. Past performance is not indicative of future results. You cannot invest directly in an index.

Then, growth stocks reached their relative bottom on April 19, 2013. Treasury yields were 1.71%. While growth stocks outperformed for years from that point, interest rates yawned, chopping around and ultimately falling to 1.36% on July 8, 2016. Yet the thesis that falling rates help yield-oriented stocks was debunked during that more than three-year spell. From April 19, 2013, to July 8, 2016—when rates were falling by 35 [basis points \(bps\)](#) to that generational low—the S&P 500 Growth Index posted a total return of 53.56% while the WisdomTree U.S. High Dividend Index rose “just” 45.12%, a gap of 844 bps (199 bps annualized).

Finally, the latest stage, which has been characterized by a more than doubling of t-note rates from their July 2016 lows. Growth has continued to outperform, this time with a sharp acceleration higher that has left dividend strategies frustrated (figure 2).

Figure 2: Zooming in on Recent History



Source: Bloomberg. Data as of 3/12/18. Past performance is not indicative of future results. You cannot invest directly in an index.

We don't deny that at the current moment, interest rate directionality is a key focus for the market; in fact, we've made the case that a [reversal of the crowded rising rates consensus could put a bid under DHS](#). And crowded is an understatement: 38 of 43 economics teams anticipate a rise in 10-Year Treasury yields by the fourth quarter of 2019, with a median target of 3.42%.¹ If they are proven wrong—and if the market keeps “caring” about rates in 2018 the way it did in 2016 and 2017—DHS could surprise investors to the upside.

But as we have shown, interest rates have been a tough investment metric over the long term. There must be something more to the dividend payers versus growth stocks decision.

That “something” is relative [valuations](#).

Flagging March 2009

It's important to take note any time a data point comes back to what it was flashing in 2008 or 2009, the crisis years. S&P 500 Growth's performance series relative to the WisdomTree U.S. High Dividend Index is back to March 12, 2009, levels, the same week the market put in its lowest close of the generation—and seven days after the end of that growth cycle. From this point, the next three years witnessed the WisdomTree Index outperform by 744 bps per year.

...And 1999

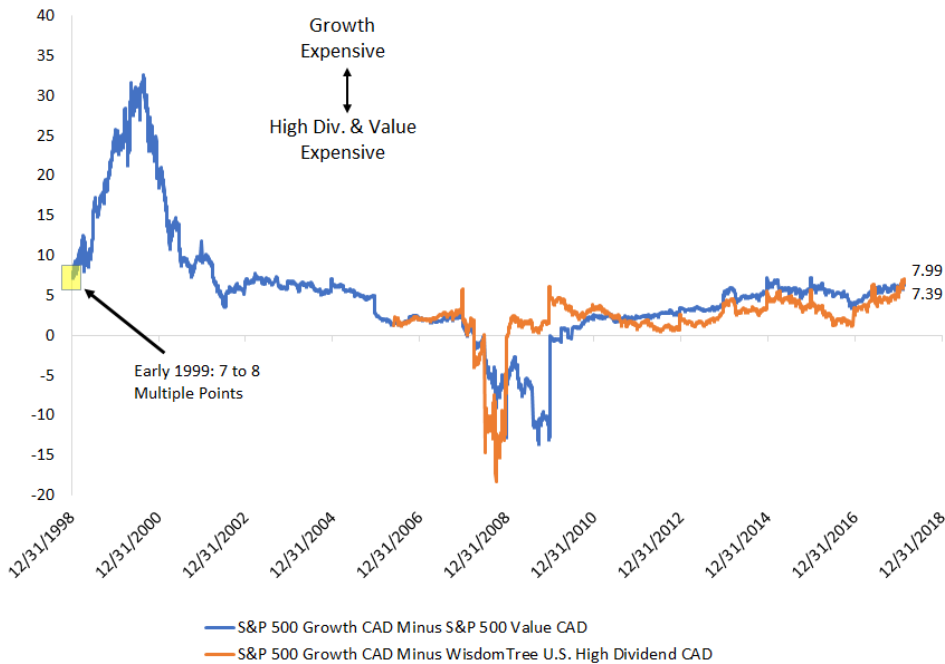
Because DHS and the WisdomTree Index it tracks were created in 2006, figure 3 goes back to the 1990s to capture two decades of growth versus [value](#) fundamentals. The S&P 500 Growth Index's [trailing price/earnings ratio](#) is 26.6, about 8 multiple points more than the WisdomTree U.S. High Dividend Index (18.6).² Similarly, the gap between the S&P 500 Growth and [S&P 500 Value indexes](#) is 7.39 multiple points.

Going back to the [tech bubble](#), we saw a gap about this wide in January 1999. We know

with hindsight that the growth stock bubble ended a year later at much higher levels. True, the current valuation gap can certainly stretch out like it did then, but backing a repeat of that legendary performance run may not be wise.

If the clock is, in fact, ticking on yesterday's market leadership, DHS could be primed if dividends come back into style.

Figure 3: S&P 500 Growth Price-to-Sales Minus S&P 500 value



Source: Bloomberg. Data as of 3/12/18. Past performance is not indicative of future results. You cannot invest directly in an index. The lowest trailing P/E differential between the S&P 500 Growth and Value indexes in 1999 was 7.2 on January 12 of that year. It broke north of 8 on 1/26/99 and accelerated inexorably higher thereafter. The gap is currently 7.39.

¹Source: Bloomberg, as of 3/12/18.

²Source: Bloomberg, as of 3/12/18.

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DEFINITIONS

Interest rates: The rate at which interest is paid by a borrower for the use of money.

S&P 500 Growth Index: A market capitalization-weighted benchmark designed to measure the growth segment of the S&P 500 Index.

10- Year Treasury: a debt obligation of the U.S. government with an original maturity of ten years.

Growth: Characterized by higher price levels relative to fundamentals, such as dividends or earnings. Price levels are higher because investors are willing to pay more due to their expectations of future improvements in these fundamentals.

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

Basis point: 1/100th of 1 percent.

Valuation: Refers to metrics that relate financial statistics for equities to their price levels to determine if certain attributes, such as earnings or dividends, are cheap or expensive.

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.

Trailing Price-to-earnings (P/E) ratio: Trailing Price-to-earnings (P/E) ratio: Share price divided by trailing 12-month earnings per share. Lower numbers indicate an ability to access greater amounts of earnings per dollar invested.

S&P 500 Value Index: A market capitalization-weighted benchmark designed to measure the value segment of the S&P 500 Index.

Tech Bubble: Market collapse between 1999-2001 that was led by technology stock.