



TAPPING THE POWER OF GLOBAL EQUITY DIVIDENDS

What we seek—and avoid—in pursuit of consistent returns.

- We believe that investing in a portfolio of high-quality, durable dividend payers and dividend growers can drive consistent risk-adjusted returns over market cycles.
- Identifying the opportunities and avoiding the traps in dividend investing requires active stock selection and a rigorous, disciplined investment approach.
- We hunt for stable, established companies with the fundamentals to support sustainable dividend growth. High dividend yields that look fragile are a red flag to us.



Yoichiro Kai
Portfolio Manager, Global Equity
Dividend Strategy

Dividend stocks have regained favor with investors amid sharp market volatility over the past 12 months. In particular, compressed valuations for once buoyant growth stocks have highlighted the role of dividends as a potential cushion for returns.

We believe that dividend investing deserves greater attention, and not just in this challenging market environment. History and our experience suggest that, over market cycles, a select group of high-quality, durable dividend payers and dividend growers can deliver consistent risk-adjusted total returns.

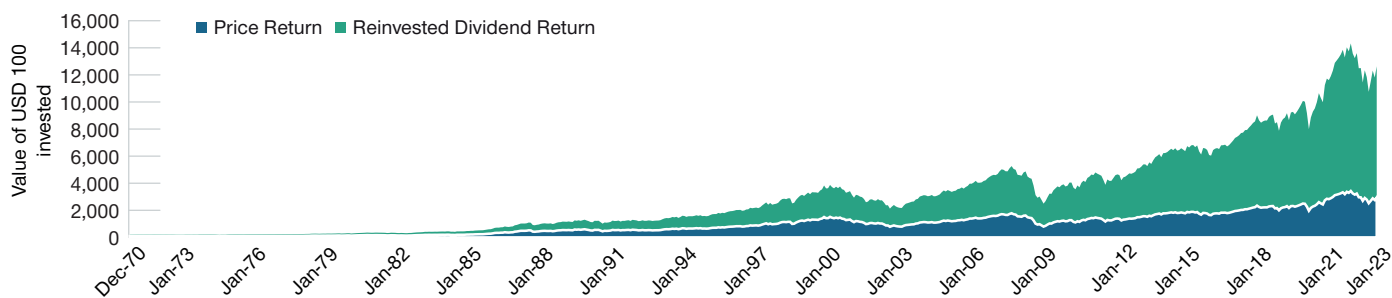
Why Dividends Matter

Dividends historically have been a powerful engine for total returns, especially when that income was reinvested over time. Since 1970, compounded dividends have accounted for over 70% of global equity returns (Figure 1).

...High dividend yields by themselves do not promise strong total returns.

FIGURE 1: Dividend Compounding Is Too Strong to Ignore

Total return composition of the MSCI World Index



Past performance is not a reliable indicator of future performance.

For illustrative purposes only, not representative of an actual investment.

As of January 31, 2023.

Source: T. Rowe Price calculations using data from FactSet Research Systems Inc. All rights reserved (see Additional Disclosures).

FIGURE 2: The Long-Term Power of Dividends Is Clear Across Regions

20-year return breakdown for major regions



Past performance is not a reliable indicator of future performance.

As of December 30, 2022.

Based on MSCI China Index, MSCI Australia Index, MSCI USA Index, MSCI AC Asia ex Japan Index, MSCI Emerging Markets Index, MSCI World Index, MSCI AC World Index, MSCI China A Onshore Index, MSCI Europe Index, MSCI Japan Index, respectively.

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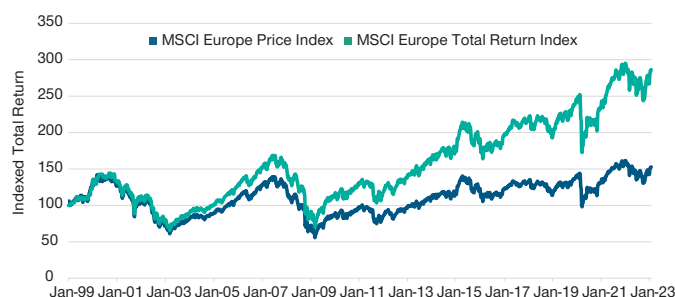
Zooming in on the last 20 years, dividends have composed a prominent part of total returns across major regions in both developed and emerging markets (Figure 2).

The importance of dividends is especially evident in markets that tend to have stronger equity income cultures. We see this in Europe, where dividends have contributed to more than 46% of total returns since 1999 (Figure 3).

That importance is even clearer with sustained dividend growth. As an example, the S&P 500 Dividend Aristocrats Index, which represents over 60 S&P 500 companies with 25 consecutive years of dividend increases, has outperformed the S&P 500 Index by more than 75% since 1989 (Figure 4). By identifying companies with the ability to sustain and grow dividends

FIGURE 3: Dividends Explain Large Differences Between Price Returns and Total Returns in Income-Oriented Europe

Indexed total returns for MSCI Europe Price Index and MSCI Europe Total Return Index



Past performance is not a reliable indicator of future performance.

As of January 27, 2023.

Source: T. Rowe Price analysis using data from Bloomberg Finance L.P. (see Additional Disclosures).

and taking an active, global approach, we believe we have the potential to drive consistent long-term returns.

From our perspective, in addition to helping drive returns, dividends are a barometer of shareholder value. Dividends can indicate companies' commitment to shareholder returns. That commitment is typically backed by managements' confidence in the long-term strength and cash-generating ability of their business models.

Moreover, we see dividends reflecting management discipline. Building a strong track record of dividend payouts understandably calls for sound judgment on capital allocation and the management of leverage. Determining the amount of cash to set aside for shareholder distributions and future investments and the optimal level of debt to take on are critical decisions to get right.

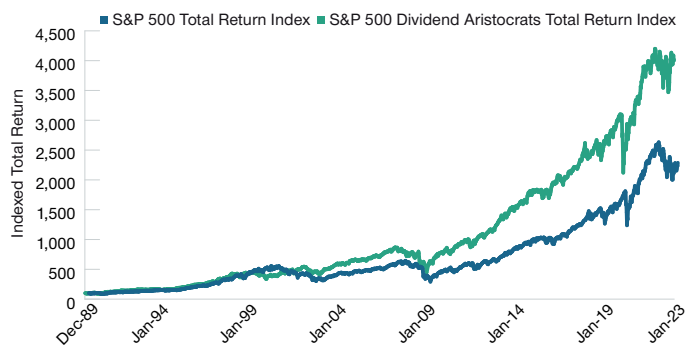
What Yields Do Not Show

But what investors commonly overlook is this: High dividend yields by themselves do not promise strong total returns. More crucial are the sustainability of the dividends and the business fundamentals supporting them. Some companies that pay hefty dividends may simply have limited growth opportunities and few uses for cash on hand. Also questionable are capital-intensive companies that overstretch themselves with high payouts to entice investors.

These examples underscore the danger of compromising company quality in exchange for high dividend yields. Such companies may struggle to maintain their dividends over time or attain the earnings growth needed to drive share price appreciation. Taken together, we would be wary of the total return profiles of these stocks.

FIGURE 4: Return Differences Are Even More Pronounced With Sustained Dividend Increases

Indexed total returns for S&P 500 Dividend Aristocrats Index and S&P 500 Index



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As of January 27, 2023.

Source: T. Rowe Price analysis using data from Bloomberg Finance L.P. (see Additional Disclosures).

Similarly, avoiding low-yield stocks without a careful evaluation of the companies' prospects comes with pitfalls. Low yet growing dividends may point to companies that are on a path of earnings expansion, with cash flows that are starting to exceed their capital expenditure needs. These stocks may ultimately generate sizable total returns through dividends and earnings growth combined. Understanding their commitment to shareholder returns and emphasis on dividends is especially important when assessing these companies.

...we seek high-quality earnings compounders that are well positioned to pay or grow dividends over time....

Selecting Dividend Payers and Dividend Growers

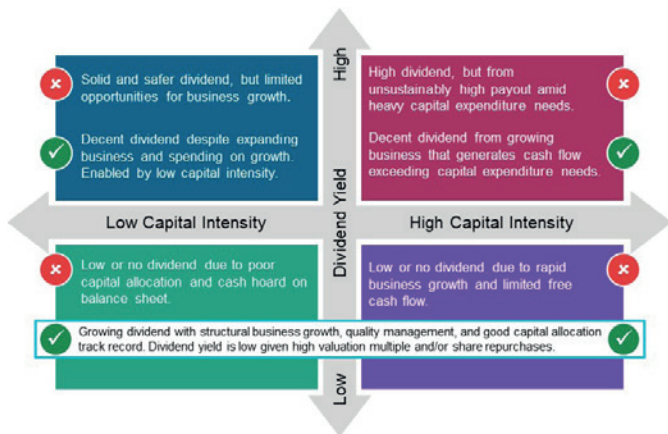
In short, stock selection is key. We believe there is a far better chance of achieving consistent risk-adjusted total returns over the long run by investing in durable dividend payers and dividend growers. Certain characteristics stand out to us in our search for these companies.

- 1. High-quality fundamentals:** Foremost on our radar are strong company fundamentals that support dividends. Healthy free cash flow growth, compounding earnings, and robust returns on invested capital are among the features that we look out for.
- 2. Attractive growth potential:** Companies should also possess what we think are attractive growth prospects. Enduring competitive advantages, favorable industry structures, and healthy end markets often enable them to get ahead.
- 3. Capital allocation discipline:** We like management teams with established track records in allocating capital and building solid balance sheets, including the sound use of leverage even in tough market conditions.
- 4. Commitment to shareholder returns:** It is vital that management teams have well-articulated dividend and share buyback policies that are in keeping with the companies' financial health and strategy

Put in another way, we seek high-quality earnings compounders that are well positioned to pay or grow dividends over time, while avoiding low-quality companies that pay unsustainable dividends. This framework guides our overall approach in assessing companies across the dividend yield and capital intensity spectrums (Figure 5).

FIGURE 5: Our Stock Selection Approach Is Guided by a Proprietary Framework

Companies we like and companies we avoid



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Companies that we seek include those that have been growing cash flow and dividends in industries benefiting from structural tailwinds. Amphenol, for example, is exposed to the rise of electrification in the automotive and industrial markets that it serves. The company is one of the world’s leading suppliers of connectors used in electric vehicles, heavy equipment, and many other areas, and electrification has broadly led to increased connector content per application. Over the past five years, management has been committed to returning a significant portion of free cash flow to shareholders.¹

Conversely, companies that appear less compelling include high dividend yielders that face secular business challenges. Consider tobacco companies,

whose generous dividends have traditionally drawn income-seeking investors. Nonetheless, the outlook for these companies has weakened amid mounting competition from new nicotine products and growing ESG concerns.²

We would also be cautious about companies that pay either no or a very low dividend yield due to their tendency to hoard cash on the balance sheet. These companies are often poor capital allocators. Companies with large capital expenditures for growth, resulting in limited free cash flow generation, would also not meet our criteria. Young technology companies are likely to fall into this category.

Pursuing Consistency

In our search for consistent total returns across bear and bull markets, our conviction lies in a distinct group of high-quality companies with the potential to pay or grow dividends sustainably. To draw a parallel with the famous fable “The Tortoise and the Hare,” we would not expect these stocks to race ahead like the hare and attain top-notch returns in any given year—a rare feat for long-term investments. Stocks we like tend to be more like the tortoise, driving steadier returns through earnings growth and dividends with the goal of providing long-term capital appreciation.

Finding companies with this risk/reward profile requires investors to look beyond headline dividend yields and delve into business fundamentals. By conducting rigorous stock-by-stock analysis, we believe we are able to construct a portfolio of the best equity income ideas from our global opportunity set. ■

The specific security identified and described does not represent all of the securities purchased, sold, or recommended for advisory clients, and no assumptions should be made that investments in the security identified and discussed were or will be profitable.

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² ESG: environmental, social, and governance.

INVEST WITH CONFIDENCESM

T. Rowe Price focuses on delivering investment management excellence that investors can rely on—now and over the long term.

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