

The Power of Dividends

Past, Present, and Future

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AVOIDING FADS CAN BE AN IMPORTANT PART OF INVESTMENT SUCCESS. When everyone is talking about an investment, it's often a sell signal, since the masses generally buy investments after they've significantly increased in value.

With this in mind, we need to wonder if all the talk about dividend-paying stocks is just a fad, or if there's real merit to the dividend argument, particularly at this point in market history. In this insight, we'll take a historical look at dividends and examine the future for dividend investors.

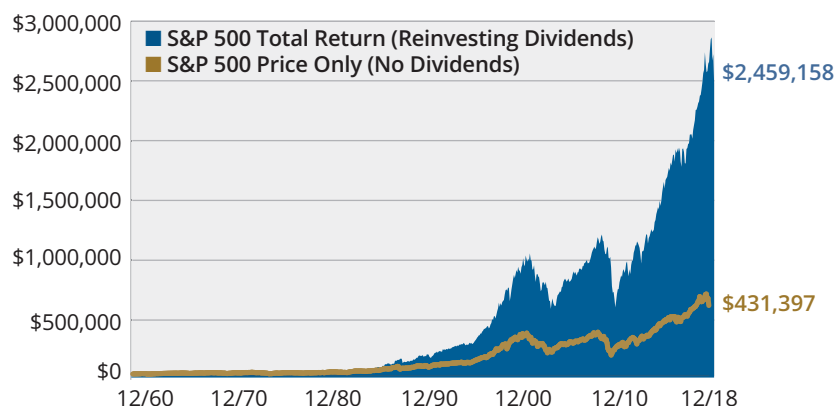
The Long-Term View

Dividends have played a significant role in the returns investors have received during the past 50 years. Going back to 1960, 82% of the total return of the S&P 500 Index¹ can be attributed to reinvested dividends and the power of compounding, as illustrated in **FIGURE 1**.

FIGURE 1

The Power of Dividends and Compounding

Growth of \$10,000 (12/1960–12/2018)



Data Sources: Morningstar and Hartford Funds, 1/19.

Past performance is not a guarantee of future results. For illustrative purposes only. Dividend-paying stocks are not guaranteed to outperform non-dividend-paying stocks in a declining, flat, or rising market. The graph is not representative of any Hartford Fund's performance, and does not take into account fees and charges associated with actual investments.

¹ S&P 500 Index is a market capitalization-weighted price index composed of 500 widely held common stocks. Indices are unmanaged and not available for direct investment.

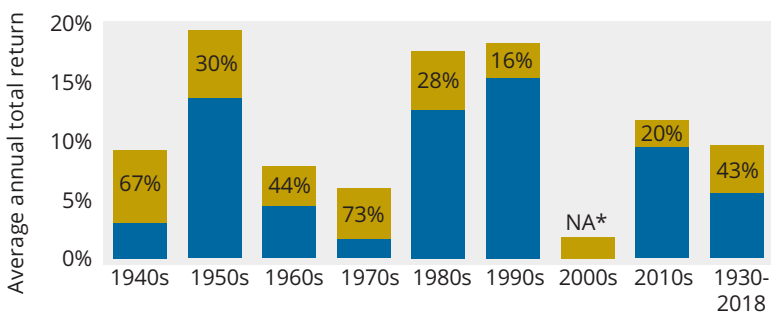
Decade By Decade: How Dividends Impacted Returns

Looking at average stock performance over a longer time frame provides a more granular perspective. From 1930–2018, dividend income's contribution to the total return of the S&P 500 Index averaged 43%. Looking at S&P 500 Index performance on a decade-by-decade basis shows how dividends' contribution varied greatly from decade to decade.

FIGURE 2

Dividends' Contribution to Total Return Varies By Decade

■ S&P 500 Dividend Contribution to Total Return
■ S&P 500 Price Only (No Dividends)



Data Sources: Morningstar and Hartford Funds, 1/19. *Total Return for the S&P 500 Index was negative for the 2000s. Dividends provided a 1.8% annualized return over the decade.

Past performance is no guarantee of future results. The graph shown is for illustrative purposes only.

Dividends played a large role in terms of their contribution to total returns during the 1940s, 1960s, and 1970s, decades in which total returns were lower than 10%. By contrast, dividends played a smaller role during the 1950s, 1980s, and 1990s when average annual total returns for the decade were well into double digits.

During the 1990s, dividends were de-emphasized. At the time, companies thought they were better able to deploy their capital by reinvesting it in their businesses rather than returning it to shareholders. Significant capital appreciation year in and year out caused investors to shift their attention away from dividends.

From 2000 to 2009, a period often referred to as the “lost decade,” the S&P 500 produced a negative return. Largely as a result of the bursting of the dot-com bubble in March 2000, stock investors once again turned to fundamentals such as P/E ratios² and dividend yields.

Dividends were de-emphasized in the 1990s, but after the dot-com bubble burst, investors once again turned their attention to dividends.

² Price/earnings “P/E” ratio is the ratio of a stock’s price to its earnings per share.

FIGURE 3 summarizes the dividend yield for the S&P 500 Index from 1970–2018. According to Yale, the median dividend yield for the entire period was 2.77%, with yields peaking in the 1980s and bottoming in the 2000s. Today, investors continue to place a high premium on the more tangible and immediate returns that dividends provide.

FIGURE 3
After Bottoming in 2000, the Yield on the S&P 500 Index Has Generally Been Rising

S&P 500 Index Dividend Yield (12/31/1969–12/31/2018)



Data Sources: Yale and Hartford Funds, 1/19.

Past performance is no guarantee of future results. For illustrative purposes only. The graph is not representative of any Hartford Fund's performance, and does not take into account fees and charges associated with actual investments.

When "High" Beat "Highest"

Investors seeking dividend-paying investments may make the mistake of simply choosing those that offer the highest yields possible. A study conducted by Wellington Management reveals the potential flaws in this thinking.

The study found that stocks offering the highest level of dividend payouts have not performed as well as those that pay high, but not the very highest, levels of dividends.

This conclusion is counterintuitive: Why wouldn't the highest-yielding stocks have the best historical total returns? Isn't the ability to pay a generous dividend a sign of a healthy underlying business?

We'll answer these questions in a moment, but we'll begin by summarizing the methodology and findings of the study.

Wellington Management began by dividing dividend-paying stocks into quintiles by their level of dividend payouts. The first quintile (i.e., top 20%) consisted of the highest dividend payers, while the fifth quintile (i.e., bottom 20%) consisted of the lowest dividend payers.

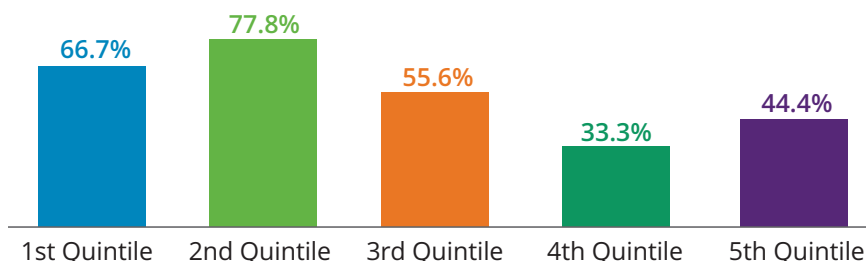
Stocks offering the highest level of dividend payouts have not performed as well as those that pay high, but not the very highest, levels of dividends.

FIGURE 4 summarizes the performance of the S&P 500 Index as a whole relative to each quintile over the past eight decades.

FIGURE 4

Second-Quintile Stocks Outperformed Most Often From 1929–2018

Percentage of Time Dividend Payers by Quintile Outperformed the S&P 500 Index (summary of data in FIGURE 5)



Data Sources: Wellington Management and Hartford Funds, 1/19. Performance data quoted represents past performance and does not guarantee future results.

The second-quintile stocks outperformed the S&P 500 Index eight out of the nine time periods (1929 to 2018), or 77.8% of the time, while first-quintile stocks came in second, beating the Index 66.7% of the time. Third-, fourth-, and fifth-quintile stocks lagged behind the first- and second-quintile dividend payers.

FIGURE 5

Compound Annual Growth Rate (%) for US Stocks by Dividend Yield Quintile by Decade

(1929–2018)

	S&P 500	1st Quintile	2nd Quintile	3rd Quintile	4th Quintile	5th Quintile
Jan-1930 to Dec-1939	-0.20%	-1.22%	0.40%	-2.44%	-0.39%	2.07%
Jan-1940 to Dec-1949	9.51%	13.92%	13.06%	10.26%	8.63%	6.83%
Jan-1950 to Dec-1959	18.33%	18.52%	20.31%	18.47%	16.57%	19.81%
Jan-1960 to Dec-1969	8.26%	8.82%	8.90%	6.45%	7.96%	9.32%
Jan-1970 to Dec-1979	6.05%	9.67%	10.23%	7.00%	7.57%	3.94%
Jan-1980 to Dec-1989	16.80%	20.23%	19.62%	17.19%	16.20%	14.66%
Jan-1990 to Dec-1999	17.96%	12.35%	15.57%	15.07%	18.07%	18.92%
Jan-2000 to Dec-2009	-0.44%	4.91%	4.57%	4.48%	1.91%	-1.77%
Jan-2010 to Dec-2018	11.83%	11.56%	12.30%	12.37%	10.92%	8.38%

Data Sources: Wellington Management and Hartford Funds, 1/19. US stocks are represented by the S&P 500 Index. Chart represents the compound annual growth rate (%) for US stocks by dividend yield quintile by decade from 1930-2009 and January 2010 to December 2018.

Past performance is no guarantee of future results. For illustrative purposes only. The graphs are not representative of any Hartford Fund's performance, and do not take into account fees and charges associated with actual investments.

Payout Ratio: A Critical Metric

One reason why second-quintile dividend stocks came out ahead is because the first-quintile's excessive dividend payouts haven't always been sustainable. The best way to measure whether a company will be able to pay a consistent dividend is through the payout ratio.

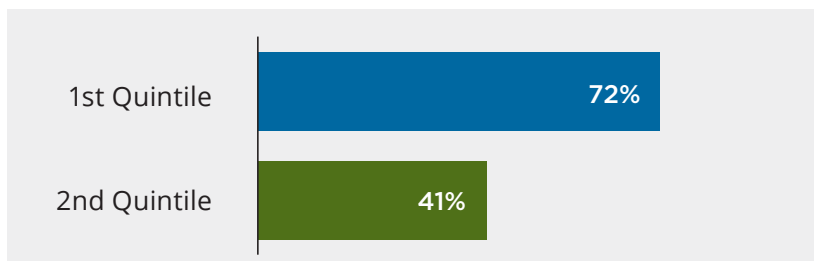
The payout ratio is calculated by dividing the yearly dividend per share by the earnings per share. A high payout ratio means that a company is using a significant percentage of its earnings to pay a dividend, which leaves them with less money to invest in future growth of the business.

The chart below illustrates the average dividend payout ratio since 1979 for the first two quintiles of dividend payers within the Russell 1000 Index.³ The first-quintile stocks had an average dividend payout ratio of 72%, while the second quintile had a 41% average payout ratio.

A payout ratio of 72% could be difficult to sustain if a company experiences a drop in earnings. Once this happens, a company could be forced to cut its dividend. A dividend cut is often viewed as a sign of weakness in the financial markets and frequently results in a decline in the price of the company's stock.

The best way to measure whether a company will be able to pay a consistent dividend is through the payout ratio.

FIGURE 6
Average Dividend Payout Ratio
(1/31/1979–12/31/2018)



Data Sources: Wellington Management and Hartford Funds, 1/19. Payout ratios illustrated are for stocks within the Russell 1000 Index.

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³ The Russell 1000 Index measures the performance of the large-cap segment of the U.S. equity universe. It is a subset of the Russell 3000 Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership.

Do Dividend Policies Affect Stock Performance?

In an effort to learn more about the relative performance of companies according to their dividend policies, Ned Davis Research conducted a study in which they divided companies into two groups based on whether or not they paid a dividend during the previous 12 months. They named these two groups “dividend payers” and “dividend non-payers.”

The “dividend payers” were then divided further into three groups based on their dividend payout behavior during the previous 12 months. Companies that kept their dividends per share at the same level were classified as “no change.” Companies that raised their dividends were classified as “dividend growers and initiators.” Companies that lowered or eliminated their dividends were classified as “dividend cutters or eliminators.” Companies that were classified as either “dividend growers and initiators” or “dividend cutters and eliminators” remained in these same categories for the next 12 months, or until there was another dividend change.

For each of the five categories (dividend payers, dividend non-payers, dividend growers and initiators, dividend non-payers, and no change in dividend policy) a total return geometric average was calculated; monthly rebalancing was also employed.

It’s important to point out that our discussion is based on historical information regarding different stocks’ dividend payout rates. Such past performance can’t be used to predict which stocks may initiate, increase, decrease, continue, or discontinue dividend payouts in the future.

Based on the Ned Davis study, it’s clear that companies that cut their dividends suffered negative consequences. In **FIGURE 7**, dividend cutters and eliminators (e.g., companies that completely eliminated their dividends) were more volatile (as measured by beta⁴ and standard deviation⁵) and fared worse than companies that never paid a dividend at all (dividend non-payers).

Lowest Risk and Highest Returns for Dividend Growers & Initiators

In contrast to companies that cut or eliminated their dividends, companies that grew or initiated a dividend have experienced the highest returns relative to other stocks since 1972—with significantly less volatility. This helps explain why so many financial professionals are now discussing the benefits of incorporating dividend-paying stocks as the core of an equity portfolio with their clients.

FIGURE 7
Average Annual Returns and Volatility by Dividend Policy
(1/31/72–12/31/18)

	Returns	Beta	Standard Deviation
Dividend Growers & Initiators	9.62%	0.88	15.62%
Dividend Payers	8.78%	0.94	16.37%
No Change in Dividend Policy	6.88%	1.00	17.76%
Dividend Non-Payers	2.40%	1.29	24.34%
Dividend Cutters & Eliminators	-0.79%	1.21	24.68%
Equal-Weighted S&P 500 Index	7.30%	1.00	17.26%

Data Sources: Ned Davis Research and Hartford Funds, 1/19. Stocks within the S&P 500 Index.

⁴ Beta is a measure of risk that indicates the price sensitivity of a security or a portfolio relative to a specified market index.

⁵ Standard deviation measures the spread of the data about the mean value.

Companies that grew or initiated a dividend have experienced the highest returns relative to other stocks since 1972—with significantly less volatility.

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Dividend Growth May Be a Key to Outperformance

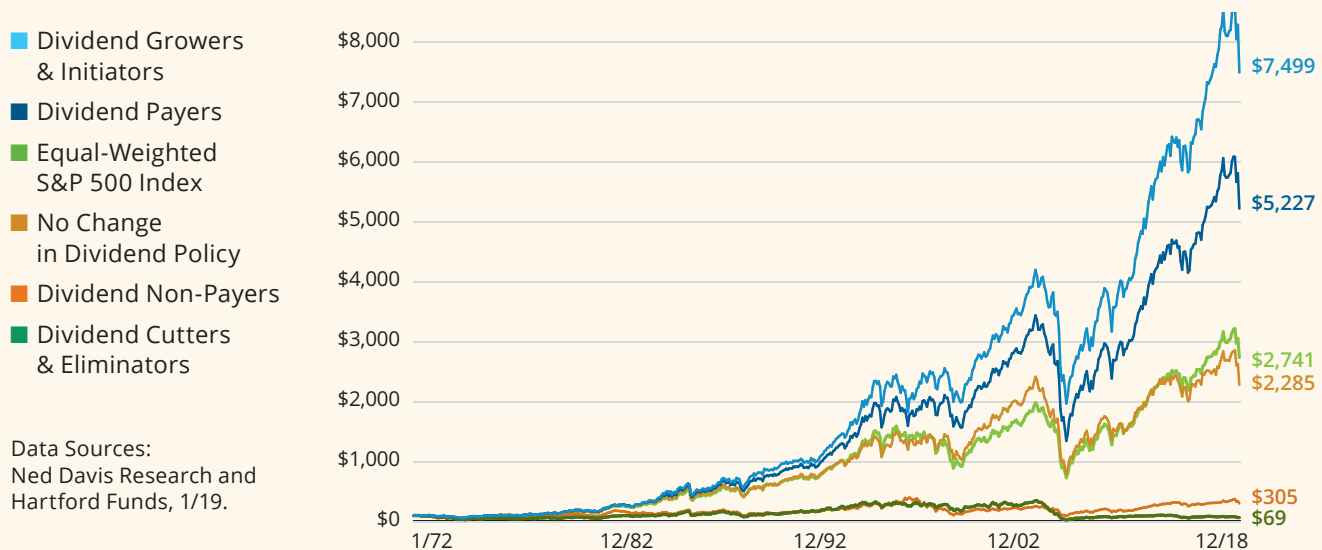
Corporations that consistently grow their dividends have historically exhibited strong fundamentals, solid business plans, and a deep commitment to their shareholders.

The market environment is also supportive of dividends. A strong US economy has helped companies grow earnings and free cash flow, resulting in record levels of

cash on corporate balance sheets (**FIGURE 9**). This excess cash should allow businesses with existing dividends to maintain, if not grow, their dividends. And while interest rates are rising, they're expected to rise slowly. This means dividend-paying stocks should continue to offer attractive yields relative to many fixed-income asset classes.

FIGURE 8

Returns of S&P 500 Index Stocks by Dividend Policy: Growth of \$100 (1/1972–12/2018)



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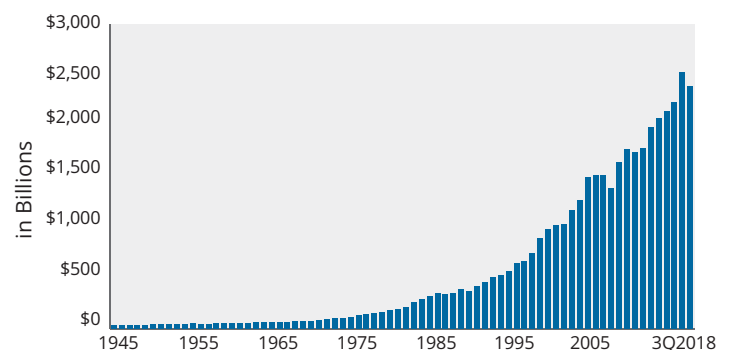
The Future for Dividend Investors

Trend 1: High Corporate Cash Could Bode Well for Dividends

In the aftermath of the financial crisis, corporations have been accruing record profits, and their balance sheets have swelled as a result. Over the past 15 years, cash on corporate balance sheets has more than doubled. Corporations can use this excess cash in a variety of ways, such as expanding their businesses or making acquisitions. While these options may be attractive in some environments, during uncertain times some corporations may be more cautious and choose to hold on to their cash in case of another economic downturn. Companies may also choose to use excess cash to initiate a dividend or increase their existing dividend payouts.

FIGURE 9

Record Levels of Cash on Corporate Balance Sheets (1945–2018)

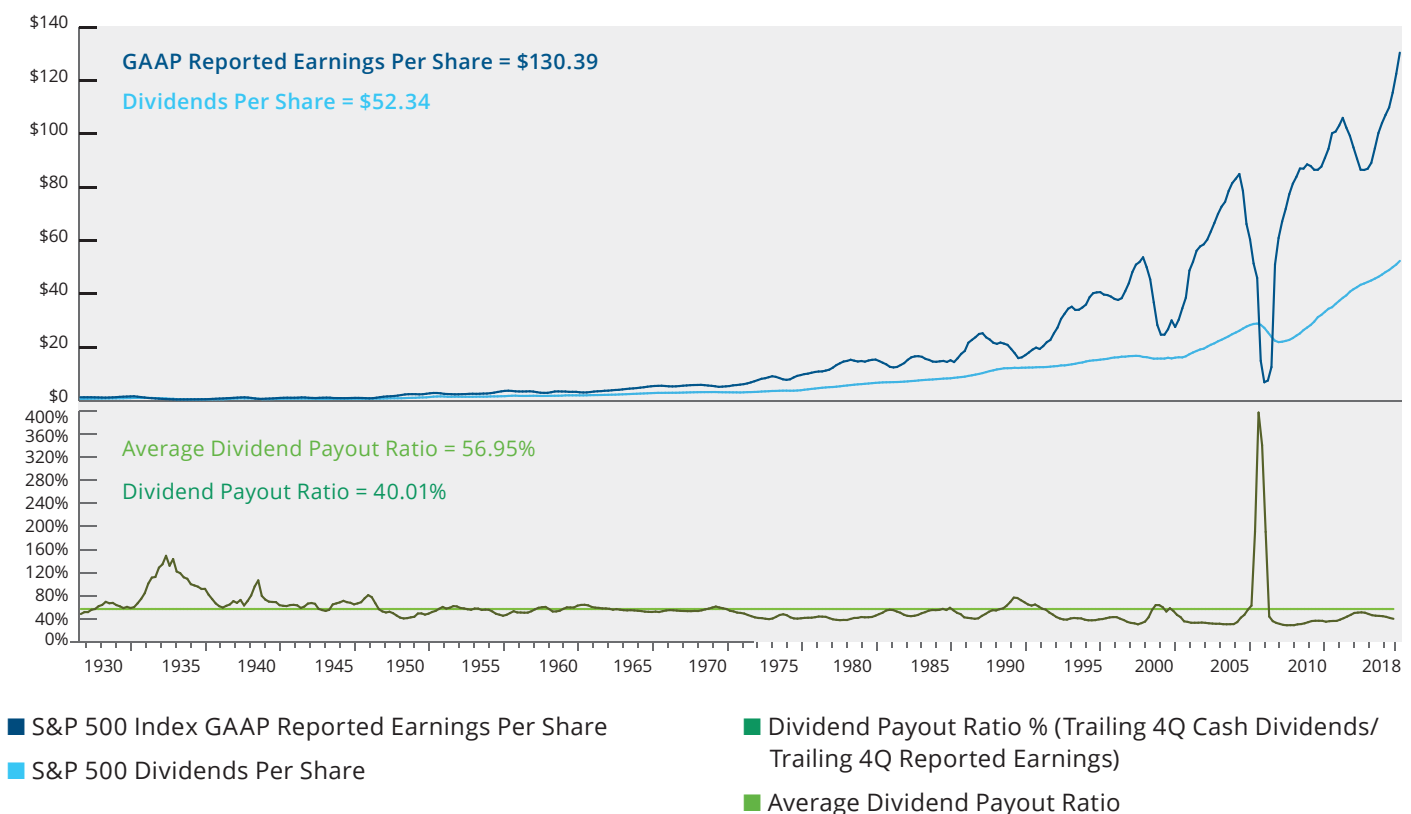


Data Sources: Federal Reserve and Hartford Funds, 1/19.

FIGURE 10 shows the confluence of two positive trends that could benefit dividend investors: high corporate profits for S&P 500 Index companies coupled with near record-low payout ratios. The average dividend payout ratio over the past 92 years has been 57%. As of December 31, 2018, the payout ratio stood at just 40%—leaving plenty of room for growth.

High corporate profits and near record-low payout ratios could benefit dividend investors.

FIGURE 10
S&P 500 Index Dividend Payout Ratio Quarterly Data (log scale)
(3/31/1926–9/30/2018)



Data Sources: Ned Davis Research and Hartford Funds, 1/19. Most recent data available.

Past performance is no guarantee of future results. For illustrative purposes only. The graph is not representative of any Hartford Fund's performance, and does not take into account fees and charges associated with actual investments.

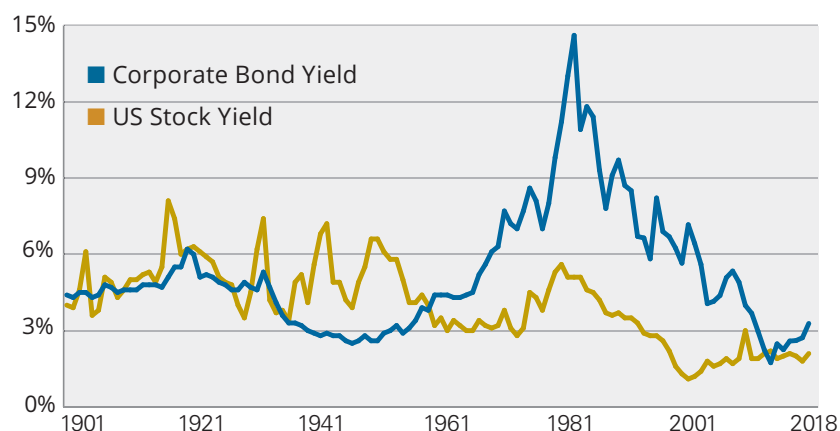
Trend 2: Low Bond Yields Could Bode Well for Dividends

With bond yields still at relatively low levels, dividend-paying stocks may be appealing to many investors who are seeking yield. For example, retiring baby boomers who are searching for income-producing investments and institutional investors seeking yield may find dividend stocks more attractive than today's low-yielding bonds.

FIGURE 11

Yields for US Stocks Compare Favorably to Corporate Bonds

(1/1/1901–12/31/2018)

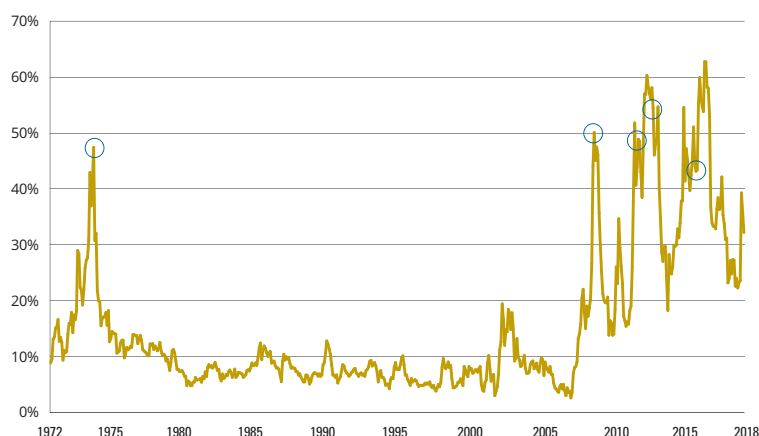


Data Sources: Bond Data - S&P High Grade Corporate Bond (1901-1968), Citigroup High Grade Corporate Bond (1969-1972, Barclays Capital Govt/Corp Bond (1973-1975), Barclays US Aggregate Bond (1976 - 2018); Stock Data - Cowles Commission All Stocks (1901-1925), S&P 500 (1926- 2018); and Hartford Funds.

As of December 31, 2018, 39% of the stocks in the S&P 500 Index have dividend yields higher than the 10-Year US Treasury. That number has fallen from the record year-end annual high reached in 2012. There have been five calendar years that ended with more than 40% of S&P 500 Index stocks yielding more than bonds. Of those years, only one—1974—was prior to 2008 (see FIGURE 12).

FIGURE 12

Percentage of S&P 500 Stocks with Dividend Yields Greater than 10-Year Treasury Yields (1/31/1972–12/31/2017)



Circles represent year-end values, as of 1974, 2008, 2011, 2012, and 2015. Data Sources: Ned Davis Research and Hartford Funds, 1/19.

Retiring baby boomers who are searching for income-producing investments and institutional investors seeking yield may find dividend stocks more attractive than today's low-yielding bonds.

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Trend 3: Financial Repression and Institutional Investors

The Fed held interest rates at a record-low rate of 0-0.25% until December 2015. Even though there have been a number of interest-rate hikes since then, the Fed stated in March that they don't expect to raise rates again in 2019. Interest rates are still low by historic standards.

We generally think of monetary policy as a catalyst to help accelerate or decelerate economic activity, but it can also be used for other purposes. By keeping interest rates low, the Fed helps keep interest payments on the national debt low. In other words, low interest rates benefit not only businesses and consumers who want to borrow money, but also the biggest debtor in the world: the US government.

Low interest rates benefit debtors and punish savers. Investors who have money in CDs,⁶ money markets,⁷ and savings accounts⁸ are receiving startlingly low rates. Meanwhile, low interest rates make it easier for the US government to make payments on outstanding debt, and these lower payments make severe austerity measures less necessary—as long as the US government doesn't continue to run up new debt while it tries to deleverage.

Low interest rates are especially problematic for institutional investors. How long can a pension plan with an actuarial discount rate of 6% or higher continue to accept 10-Year US Treasury Bonds⁹ that yield around 3%?

Institutional investors who have identified the trend toward financial repression have numerous options including high-yield bonds,¹⁰ bank loans,¹¹ sovereign debt of foreign countries,¹² REITs,¹³ and dividend-paying stocks.¹⁴

In fact, since 2008, institutional investors have poured nearly \$46 billion into equity-income funds while individual investors have withdrawn nearly \$147 billion from them over the same time period (see **FIGURE 13**). It's not uncommon for institutional investors to be ahead of the general public when it comes to investing, but how long will this striking disparity last?

Low interest rates make it easier for the US government to make payments on outstanding debt, and these lower payments make severe austerity measures less necessary.

⁶ A CD (certificate of deposit) is a savings certificate entitling the bearer to receive interest. A CD bears a maturity date, a specified fixed interest rate and can be issued in any denomination. CDs are insured up to \$250,000 per depositor by the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Association (NCUA).

⁷ **Money market funds are not insured or guaranteed by the Federal Deposit Insurance Corporation (FDIC) or any other government agency. Although the funds seek to preserve the value of the investment at \$1.00 per share, it is possible to lose money by investing in the funds.**

⁸ A savings account is an account provided by a bank for individuals to save money and earn interest on the cash held in the account. Savings accounts are typically insured by the Federal Deposit Insurance Corporation (FDIC).

⁹ US Treasury Bonds are backed by the US government and are guaranteed as to the timely payment of principal and interest. This guarantee does not apply to the value of fund shares.

¹⁰ High-yield securities, or "junk bonds," are rated below-investment-grade because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities.

¹¹ Bank loans are below-investment-grade, senior secured, short-term loans made by banks to corporations. They are rated below-investment-grade because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities.

¹² A government bond is a bond issued by a national government denominated in the country's own currency. Bonds issued by national governments in foreign currencies are normally referred to as sovereign bonds. Timely payment of interest and principal payments on sovereign debt is dependent upon the issuing nation's future economic health and taxing power.

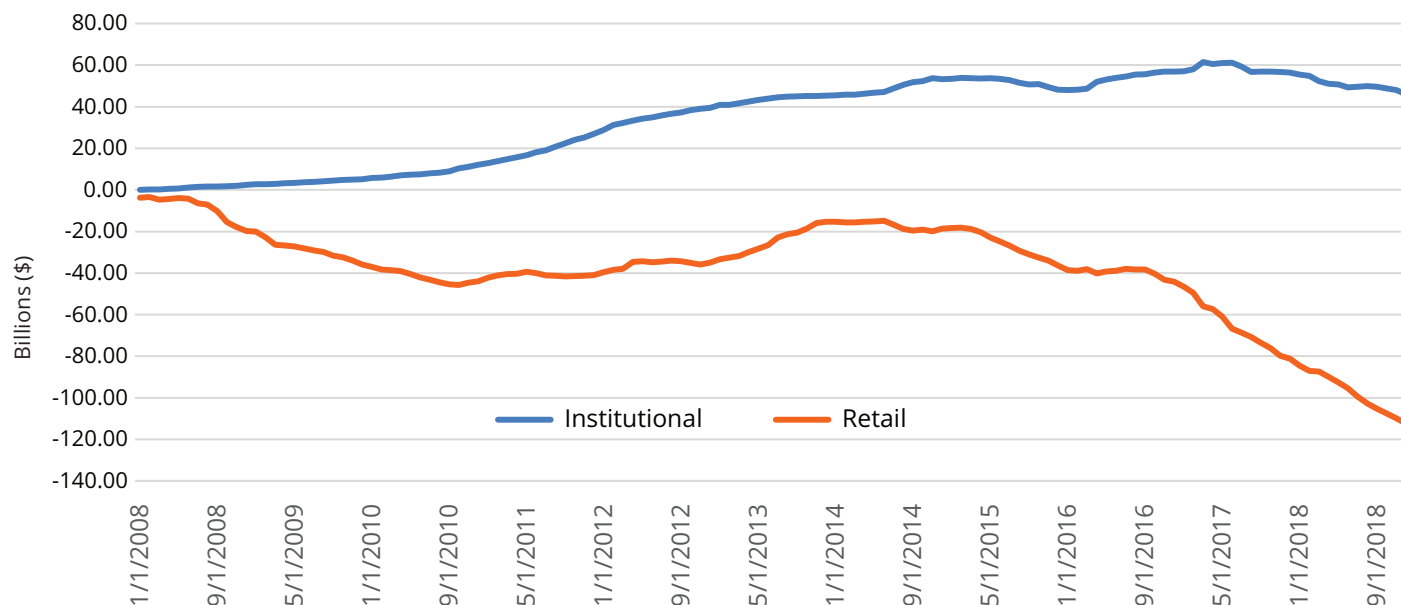
¹³ A REIT, which stands for Real Estate Investment Trust, is a company that owns or manages income-producing real estate. REITs are dependent upon the financial condition of the underlying real estate. Risks associated with REITs include credit risk, liquidity risk, and interest-rate risk.

¹⁴ A stock is an instrument that signifies an ownership position (called equity) in a corporation, and represents a claim on its proportional share in the corporation's assets and profits. Dividends are a distribution of a portion of a company's earnings, decided by the board of directors, to a class of its shareholders. There are no guarantees connected with the dividend payouts for dividend-paying stocks.

FIGURE 13

Institutional Investors Have Gravitated to Equity-Income Mutual Funds While Individual Investors Have Fled Them

Cumulative Net Asset Flows 1/2008–12/2018



Sources: Morningstar and Hartford Funds, 1/19.

Summary

Dividends have historically played a significant role in total return, particularly when average annual equity returns have been lower than 10% during a decade.

Stocks in the highest quintile of dividend yields have historically underperformed stocks in the second quintile. Therefore, investors should only use yield as one consideration when selecting a dividend-paying investment.

Furthermore, dividend growers and initiators have historically provided greater total return with less volatility relative to companies that either maintained or cut their dividends.

Trends that bode well for dividend-paying stocks include historically high levels of corporate cash, historically low bond yields, and baby boomers' demand for income that will last throughout retirement.

Today's interest rates are leading to financial repression as a way for the US government to help reduce the deficit without severe austerity measures. This has led institutional investors to invest in heavily in dividend-paying stocks and strategies, which has helped bolster their performance. This trend shows no sign of abating as long as interest rates continue to remain relatively low, and demand for these investments will only grow if retail investors follow the lead of institutional investors.

Hartford Funds Dividend-Paying Funds

	Class I Ticker
Hartford Equity Income	HQIIX
Hartford Dividend and Growth	HDGIX
Hartford Balanced Income	HBLIX

Investors should carefully consider a fund's investment objectives, risks, charges and expenses. This and other important information is contained in a fund's full prospectus and summary prospectus, which can be obtained by visiting hartfordfunds.com. Please read it carefully before investing.

Important Risks: Investing involves risk, including the possible loss of principal. • There is no guarantee a fund will achieve its stated objective. Security prices fluctuate in value depending on general market and economic conditions and the prospects of individual companies. • Fixed income security risks include credit, liquidity, call, duration, and interest-rate risk. As interest rates rise, bond prices generally fall. • For dividend-paying stocks, dividends are not guaranteed and may decrease without notice. • Foreign investments may be more volatile and less liquid than U.S. investments and are subject to the risk of currency fluctuations and adverse political and economic developments. • Different investment styles may go in and out favor, which may cause a fund to underperform the broader stock market.

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