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Eat My Shorts, Inflation

Dividend-paying stocks can help you offset the damaging impacts of inflation on your portfolio.

Inflation has re-entered our collective vocabulary for the first time since "The Simpsons" first aired more than 30 years ago. Investors may be a little rusty remembering how to keep inflation from eroding purchasing power in their portfolios—or for younger investors, it could be the first time inflation has ever been a concern. D-oh!

The good news is there's more than one way to help hedge against inflation in your portfolio. We think it's worth considering an option that may not be top of mind: dividend-paying equities.

Everything's Coming Up Milhouse (for Dividends)

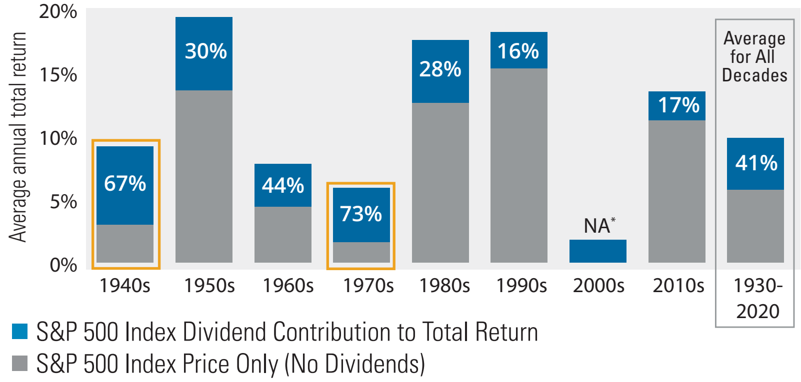
Since inflation is often associated with strong economic growth, stocks in general tend to be well-positioned to withstand it over the long term. Today, wage inflation is a stubborn driver of inflation. This should give companies with pricing power—the ability to pass price increases along to consumers—a distinct advantage going forward.

In addition to pricing power, another competitive advantage is the ability to pay steady dividends. Dividends don't just benefit shareholders, they've also historically added a substantial portion of return to the market as a whole.

For example, look at dividends' contribution to market returns by decade (**FIGURE 1**). On average, dividends have accounted for 41% of market returns since 1930. Two decades far exceeded that average: the 1940s and the 1970s. Rising inflation was in play during both.

- In the late 1940s, supply shortages combined with pent-up demand after World War II. While the S&P 500 Index produced a respectable return overall for the decade, a majority of the returns (67%) were generated by dividends.
- In the 1970s, surging oil prices caused the most infamous period of American inflation. The market notched another positive return, but this time, a whopping 73% of the S&P 500's returns came from dividends.

FIGURE 1
Dividends Comprised a Majority of Market Returns During High Inflation



Key Points

- Dividend-paying stocks may be an overlooked option for investors looking to help hedge against inflation.
- On average, dividends have accounted for 41% of market return since the 1940s—and the ratio increases for decades with higher inflation.
- During inflationary periods since the 1970s, dividend-paying stocks generally outperformed non-dividend paying stocks.

Past performance does not guarantee future results. Indices are unmanaged and not available for direct investment. *Total return for the S&P 500 Index was negative for the 2000s. Dividends provided a 1.8% annualized return over the decade. **S&P 500 Index** is a market capitalization-weighted price index composed of 500 widely held common stocks. For illustrative purposes only. Data Sources: Morningstar and Hartford Funds, 2/21.

You Don’t Win Friends With Salad

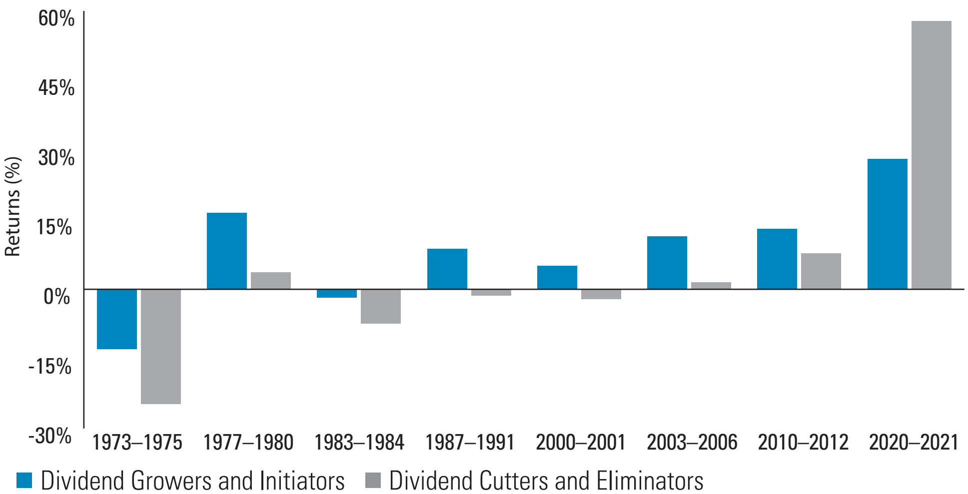
Dividends may bolster the market’s overall returns, but for a more granular look we examined the performance of dividend-paying stocks vs. non-dividend paying stocks during periods of rising inflation. There have been eight such periods since the 1970s. In all but the current instance of inflation, which has yet to fully play out, dividend-paying companies outperformed those that didn’t pay dividends.

More importantly, during the seven time periods in which dividend-paying stocks outperformed, the performance gap widened significantly between the companies that were able to consistently increase their dividends and the companies that cut or stopped paying dividends altogether.[1]

In all but one instance of rising inflation since 1970, dividend-paying companies outperformed those that didn’t pay dividends.

FIGURE 2

Companies That Grew Dividends Outperfomed Companies That Cut Them During Periods of Rising Inflation



Inflationary periods defined as a rise in Core CPI of approximately 1% or more. **Core CPI**, or the Consumer Price Index, is defined by the Bureau of Labor Statistics as a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services excluding food and energy prices. Source: Ned Davis Research, as of 9/30/21.

Don’t Have a Cow, Man

In other words, not all dividend-paying stocks are created equal or can provide the same level of performance against inflation. But enlisting professional managers can help you spot the difference.

For example, the Hartford Dividend and Growth Fund seeks financially sound companies, which the Fund’s portfolio managers believe are currently undervalued by the market, that have successfully grown both their earnings and dividends. This matters because companies that can grow their dividends may be better positioned to outpace inflation.

In addition, the Fund analyzes the current economic cycle and which industries could stand to benefit. Particularly today, this can help evaluate which companies may be better positioned to take advantage of rising prices going forward—and which may not be. As discussed earlier, pricing power is a competitive advantage when inflation is on the rise. The Fund seeks to capitalize on this advantage by emphasizing popular brands and products that are well-established. These companies may be in a better position to pass price increases along to consumers, and, therefore, may be more resilient against inflationary concerns.

Eat My Shorts, Inflation

Bart Simpson's iconic catchphrase may be irreverent, but his attitude likely resonates with investors trying to combat the damaging effects of inflation in their hard-earned portfolios. With their history of enhancing market returns and helping investors outpace inflation, dividend-paying stocks may not stand up to authority figures quite like Bart, but they may make for a savvy investment option in your portfolio.

Dividend-paying stocks may make for a savvy investment option in your portfolio.

For more information on investments than can help your portfolio combat inflation, talk to your financial professional.

[1] Ned Davis Research conducted a study in which they divided companies into two groups based on whether they paid a dividend during the previous 12 months (dividend-paying stocks) or not (non-dividend paying stocks). 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.

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