2022 is the Year for Dividend Growers to Shine

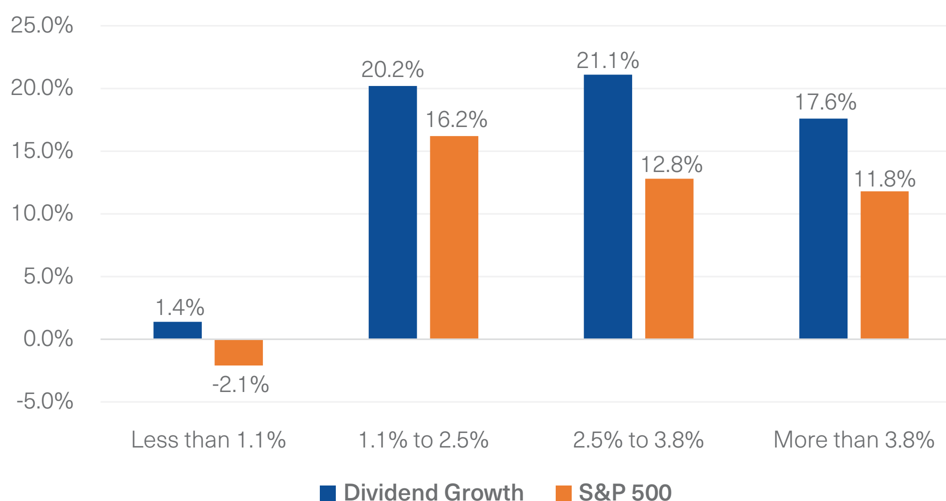
Funds in focus: Brompton Global Dividend Growth ETF (BDIV), Brompton European Dividend Growth ETF (EDGF), Dividend Growth Split Corp. (DGS, DGS.PR.A), Global Dividend Growth Split Corp. (GDV, GDV.PR.A)

2022 has had a turbulent start following a 29% gain for the S&P 500 and a 25% up year for the S&P/TSX Composite in 2021. The sell-off in January was broad based at first glance, but upon closer look, growth stocks sold off disproportionately more than value stocks and U.S. indices have endured bigger drawdowns compared to Canada and Europe. How to position this year given high inflation, Fed rate hikes, a flattening yield curve, rising volatility and the ongoing Russia-Ukraine conflict is on the top of every investor's mind. In this latest Insights edition, we attempt to answer some of these questions.

1. Dividend growers outperform in inflationary periods

Dividend growth equities have historically outperformed in an inflationary environment (Exhibit 1); the magnitude of outperformance tends to be bigger when inflation levels, as measured by the year over year change in CPI, are higher. When inflation is above 2.5%, the difference between the average return of dividend growth stocks versus the S&P 500 index is greater than 5%, while the outperformance was less than 5% when inflation was lower. The latest (Feb 10, 2022) U.S. inflation print showed January CPI increasing 7.5% compared to the year before, the highest rate since 1982. Inflation is not expected to stay at this level throughout the year, as we believe many of the culprits for inflation, including supply chain disruptions, COVID variants and labor shortages, will eventually get resolved. But as long as inflation levels stay above the historical average of 2.5%, dividend growth stocks should be able to generate attractive returns for shareholders.

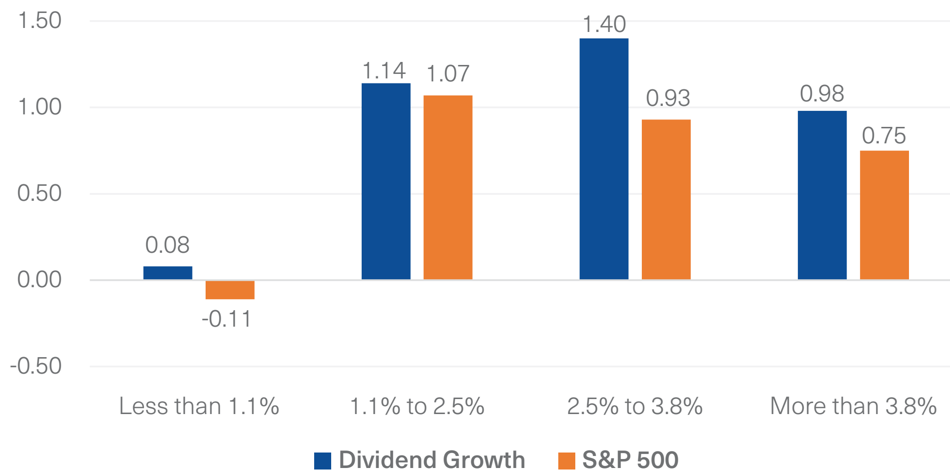
Exhibit 1: Average year-over-year total return since 1990 at various CPI levels



Source: BMO Capital Markets (January 19, 2022)

Moreover, dividend growers have historically generated better risk-adjusted returns, as measured by the Sharpe ratio, during inflationary periods (Exhibit 2).

Exhibit 2: Average Sharpe ratio since 1990 at various CPI levels

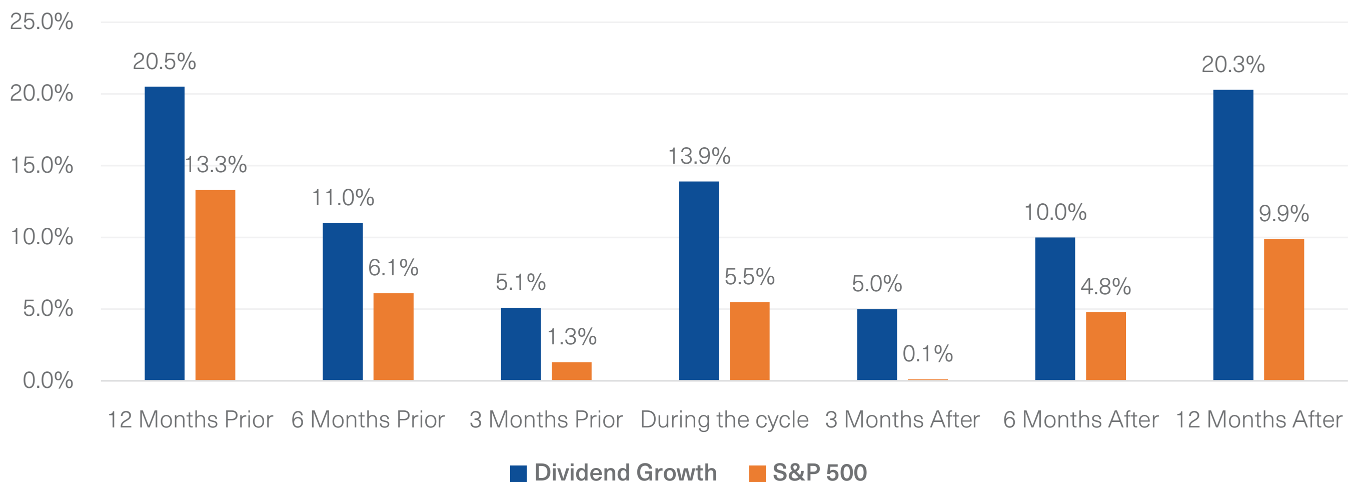


Source: BMO Capital Markets (January 19, 2022)

2. Dividend growth stocks typically outperform around Fed hiking cycles

Dividend growth stocks have also shown to generate superior performance around Federal interest rate hiking cycles (Exhibit 3). As shown below, the average total return of dividend growth stocks has consistently outperformed the S&P 500 both prior to, during and post rate hikes. Fed rate hikes typically get priced in the market months before the actual hike. Changes in expectations, such as the timing and the pace of rate hikes, can jolt the stability of equity markets, leading to higher volatility. That's why investors are advised to pre-position before the expected rate hikes. According to Bloomberg, currently the market is pricing in 5-6 rate hikes this year, with the first one in March. Exogenous shocks like Russia's invasion of Ukraine also causes volatility to spike. Given the stability of their businesses, dividend growth stocks are often able to provide shelter in volatile times.

Exhibit 3: Average total return around Fed hikes



Source: Bloomberg, as of February 11, 2022

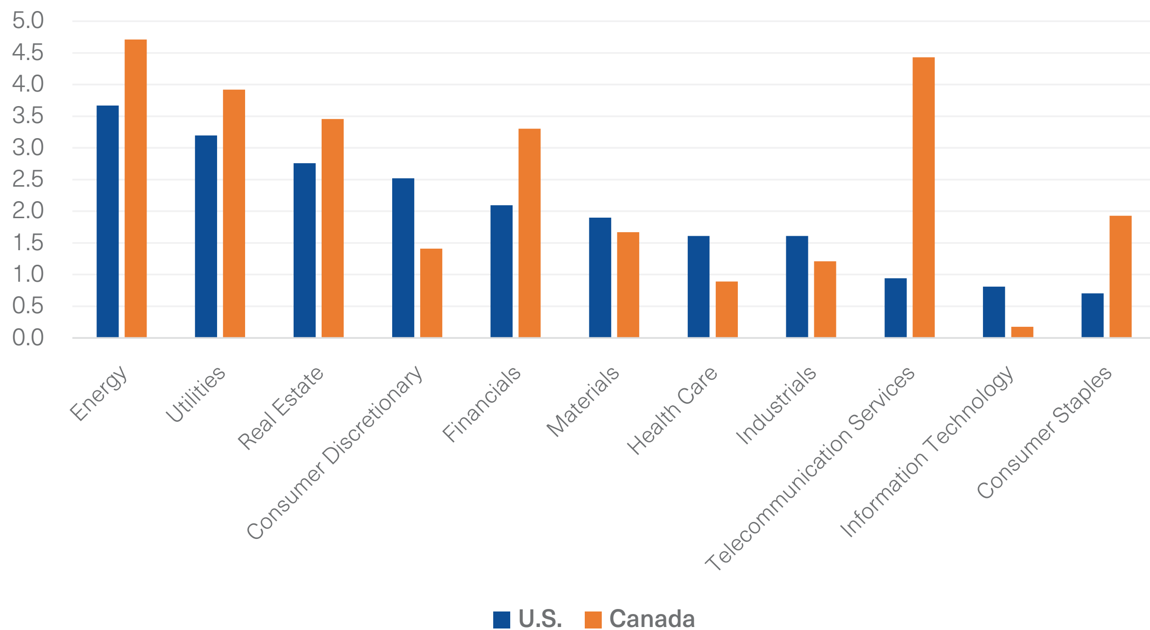
3. There is no alternative

Record low interest rates and negative real yields means that fixed income, and to some extent, traditional 60/40 portfolios, have performed poorly. This was also especially evident in the past month, where we saw a sharp bond sell-off led by higher real interest rate yield. Given the scarcity of attractive yield in the fixed income space, we believe dividend yielding securities can help fill the void.

Following 3 consecutive years of double digit returns in the S&P 500, we don't expect the same level of price appreciation this year as GDP growth normalizes and Fed policy tightens. All else being equal, a tighter monetary policy implies a falling P/E ratio, which means that dividends will comprise a larger share of investors' total returns. Since 1988, over half of the S&P 500's returns have come dividends.

Currently sectors including Energy, Utilities and Real Estate screen well in terms of generating the highest dividend yield in the U.S. In Canada, Energy, Telecommunications Services, Utilities, Real Estate and Financials are the best sectors to be in for dividend return.

Exhibit 4: Estimated 2022 dividend yield by sector



Source: Bloomberg, as of February 10, 2022

Brompton's Approach

Brompton offers a variety of Dividend Growth products including Brompton Global Dividend Growth ETF (BDIV), Brompton European Dividend Growth ETF (EDGF), Dividend Growth Split Corp. (DGS, DGS.PR.A), and Global Dividend Growth Split Corp. (GDV, GDV.PR.A), which are all designed to provide stable equity returns for investors through the cycle by investing in well-diversified portfolios of dividend growth equities. Our Portfolio Management team employs both top-down and bottom-up market analysis to construct portfolios with strong earnings growth, pricing power and FCF growth. In addition, we use an active covered call writing overlay to enhance risk-adjusted returns.

This document is for information purposes only and does not constitute an offer to sell or a solicitation to buy the securities referred to herein. The opinions contained in this report are solely those of Brompton Funds Limited ("BFL") and are subject to change without notice. BFL makes every effort to ensure that the information has been derived from sources believed to be reliable and accurate. However, BFL assumes no responsibility for any losses or damages, whether direct or indirect which arise from the use of this information. BFL is under no obligation to update the information contained herein. The information should not be regarded as a substitute for the exercise of your own judgment. Please read the annual information form or prospectus before investing.

Commissions, trailing commissions, management fees and expenses all may be associated with exchange-traded fund investments. Please read the prospectus before investing. Exchange-traded funds are not guaranteed, their values change frequently and past performance may not be repeated.

You will usually pay brokerage fees to your dealer if you purchase or sell shares of the investment funds on the Toronto Stock Exchange or other alternative Canadian trading system (an "exchange"). If the shares are purchased or sold on an exchange, investors may pay more than the current net asset value when buying shares of the investment funds and may receive less than the current net asset value when selling them.

There are ongoing fees and expenses with owning shares of an investment fund. An investment fund must prepare disclosure documents that contain key information about the fund. You can find more detailed information about the fund in the public filings available at www.sedar.com. Investment funds are not guaranteed, their values change frequently and past performance may not be repeated.

Certain statements contained in this document constitute forward-looking information within the meaning of Canadian securities laws. Forward-looking information may relate to matters disclosed in this document and to other matters identified in public filings relating to the Funds, to the future outlook of the Funds and anticipated events or results and may include statements regarding the future financial performance of the Funds. In some cases, forward-looking information can be identified by terms such as "may", "will", "should", "expect", "plan", "anticipate", "believe", "intend", "estimate", "predict", "potential", "continue" or other similar expressions concerning matters that are not historical facts. Actual results may vary from such forward-looking information. Investors should not place undue reliance on forward-looking statements. These forward-looking statements are made as of the date hereof and we assume no obligation to update or revise them to reflect new events or circumstances.

BROMPTON FUNDS

VALUE
INTEGRITY
PERFORMANCE
THE FOUNDATION FOR EXCELLENCE

Investor Relations
PHONE 416.642.6000
TOLL FREE 1.866.642.6001
FAX 416.642.6001
EMAIL info@bromptongroup.com

Website
www.bromptongroup.com

Address
Bay Wellington Tower,
Brookfield Place
181 Bay Street
Suite 2930, Box 793
Toronto, Ontario M5J 2T3