Dividend Aristocrats: A Class Apart

February 2019 | By Daniel Ung, CFA, CAIA, FRM, *Senior Smart Beta ETF Strategist*

Dividend investing is about more than just yield — quality matters, too. This is particularly true in the current late economic cycle, when company fundamentals are more important. SPDR offers a suite of Dividend Aristocrats ETFs, which generate income via fundamentally strong companies.

Overview

- In the face of heightened late-cycle volatility and robust economic growth, investors may wish to **focus on defensive equity strategies that generate income through 'quality' companies.**
- While we expect global growth to slow in 2019, we feel that US equities may offer a pocket of opportunity given that economic and earnings growth remain strong there.
- The S&P Dividend Aristocrats strategies target companies with long-term dividend track records, ensuring that only the most financially sound, highest quality companies are included.
- With the largest dividend ETF AUM in Europe tracking the S&P Dividend Aristocrats Index strategies, **the SPDR Dividend Aristocrats UCITS range is a leader in Europe.**

Favour US Equities in 2019 — But Beware of Volatility

While global growth is expected to slow globally in 2019, State Street Global Advisors believes that US equities are still the place to be because both economic and earnings growth remain strong. However, investors should be cognisant of the volatility associated with late economic cycles.

From both a macro and fundamental standpoint, we see reasons that US equities could continue to do well, although there are downside risks to monitor. Given a range of uncertainties — such as the Fed's rate hike plans, US-China trade disputes, and where we are in the economic cycle — there could be heightened volatility ahead.

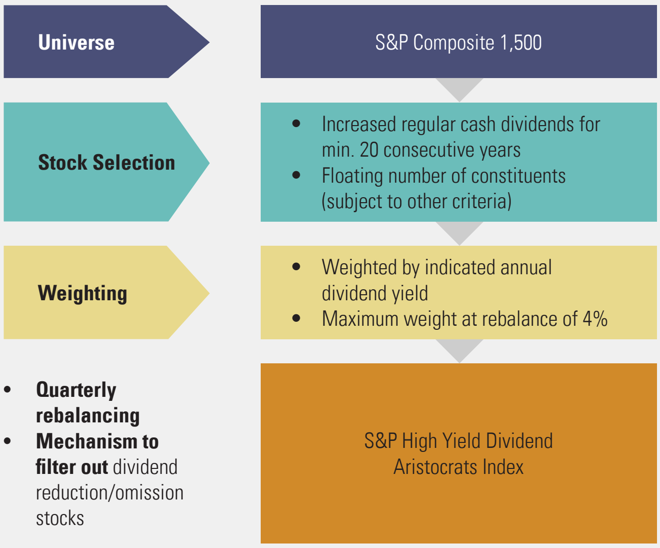
In light of this backdrop, our strategists favour defensive US equities as a part of core investment allocations, in particular the quality Dividend Aristocrats, to help investors 'smooth' their potentially bumpy investment journey.

Exercise Caution in Late Economic Cycles

With more volatility expected on the horizon, we believe that investors should be selective and focus on defensive equities in the US.

In our view, the Dividend Aristocrats strategy is well positioned for the current market environment. Through a filtering process (see Figure 1), the strategy emphasises companies with a proven dividend track record. **The long-term ability of a company to continuously pay an increasing level of regular, cash dividends often indicates a stable business model and consistent cash flows.** For this reason, these companies could be best suited to weather any market turbulence.

Figure 1: S&P High Yield Dividend Aristocrats Stock Selection Process



Source: State Street Global Advisors, as of 31 January 2019. The above diagram is for illustrative purposes only.

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Fundamentals Still Support US Equities

While US equities saw a severe pullback in late 2018, the market consensus is that US equities could still outperform other developed markets. Growth in earnings could still remain strong, although they will likely moderate from the lofty levels that we saw last year.

One of the drivers for earnings growth is that companies could repatriate overseas earnings to the US, a portion of which they could return to shareholders. **Capital expenditure may also increase as a result of US tax reforms and low unemployment levels.** Together, these factors would continue to support US equities.

A Relatively Attractive Risk-Return Profile

From January 2000 to January 2019, the S&P High Yield Dividend Aristocrats Index outperformed the S&P 500 Index by nearly 5% p.a., and with a reduced level of risk.[1] Recent performance has been equally impressive (see Figure 3b). **The combination of a higher return and lower risk profile led to a near doubling of the return per unit of risk of the Dividend Aristocrats strategy, compared to the S&P 500 Index (see Figure 2).**

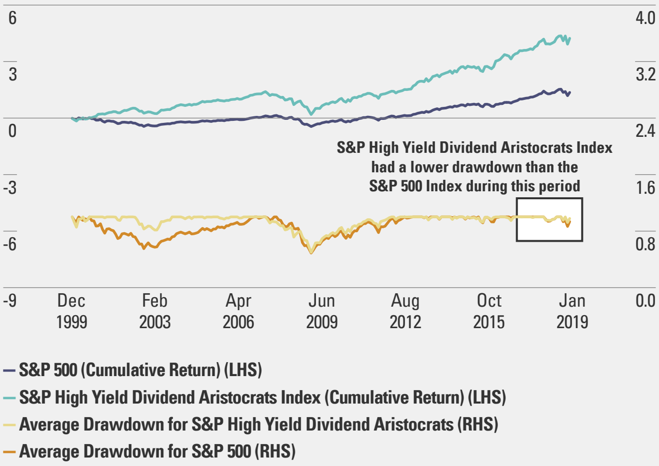
In addition to a lower level of total risk, the S&P High Yield Dividend Aristocrats Index incurred less market risk and often targeted countercyclical companies. Its beta was 0.74 over the entire period, which is 26% lower than the S&P 500 Index.

In regards to maximum drawdown during the same period, the S&P High Yield Dividend Aristocrats Index was also stronger. **Its maximum drawdown was about 49%, whereas the S&P 500 Index was about 51%.**

This combination of higher return and relatively lower risk that makes the Dividend Aristocrats an appealing strategy in an environment such as the current one.

[1] Source: Bloomberg, SSGA, as of Jan 2019. Monthly Return from Jan 2000 to Jan 2019.

Figure 2: Return and Drawdown of the S&P High Yield Dividend Aristocrats and S&P 500



Source: State Street Global Advisors, Bloomberg Finance L.P., as of December 2018. Past performance is no indication of future returns.

Figure 3a: Performance of SPDR S&P US Dividend Aristocrats UCITS ETF versus S&P High Yield Dividend Aristocrats Index (Net Returns in $, in %)

	1 Month	3 Months	YTD	1 Year	3 Years	5 Years	Since Inception
							14-Oct-11
SPDR S&P US Dividend Aristocrats UCITS ETF	6.28	2.63	6.28	0.88	13.12	10.4	12.76
S&P High Yield Dividend Aristocrats Index	6.29	2.58	6.29	0.83	13.11	10.38	12.72
Difference	**-0.01**	**0.05**	**-0.01**	**0.06**	**0.01**	**0.01**	**0.04**

Figure 3b: Performance of the S&P High Yield Dividend Aristocrats Index versus the S&P 500 Index (Net Returns in $, %)

	1 Month	3 Months	YTD	1 Year	3 Years	10 Years
S&P High Yield Dividend Aristocrats Index	6.29	2.58	6.29	0.83	13.11	10.38
S&P 500 Index	7.97	0.7	7.97	-2.9	13.32	10.27
Difference	**-1.68**	**1.88**	**-1.68**	**3.73**	**-0.21**	**0.11**

Source: State Street Global Advisors, Bloomberg Finance L.P., as at 31 January 2019. **Net of all fees. Performance quoted represents past performance, which is no guarantee of future results. Investment return and principal value will fluctuate, so you may have a gain or loss when shares are sold. Current performance may be higher or lower than that quoted. The performance data do not take account of the commissions and costs incurred on the issue and redemption, or purchases and sale, of units. All results are historical and assume the reinvestment of dividends and capital gains. Visit spdrs.com for most recent month-end performance.** Performance returns for periods of less than one year are not annualised. Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

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