
Global Equity Income: dividend update

Global Equities | 1 May 2020



Andrew Harvie
Client Portfolio Manager,
Global Equities

The Covid-19 outbreak represents perhaps the largest disruption to the global economy outside of the world wars. It is challenging families, companies and governments around the globe. Investment markets are attempting to weigh up the support from central banks versus the economic impact of the containment measures, but the economy is effectively on hold and we will doubtless experience a sharp global recession.

The crisis has obvious implications for companies' cash flows and, consequently, their ability to return cash to shareholders (ie, pay a dividend). In this update, we wish to provide some insight into the global dividend landscape and update you on how our own Global Equity Income strategy has responded.

An unprecedented headwind

Lockdown has hit both supply and demand in a way that we could never have predicted. It is inevitable that the Covid-19 pandemic will negatively impact most businesses and it is asking difficult questions of management teams. One key area of investor concern is on companies' ability to pay a dividend.

This is not the first time since we launched the Threadneedle Global Equity Income strategy that we have seen a widespread reduction in dividend payments. Over the course of the global financial crisis (GFC), they dropped by circa 20%. However, even during the GFC, there was still reasonable consumption, albeit muted.

If a company's cash flow is impaired (ie, it dries up), then paying dividends to shareholders simply cannot – and arguably should not – be sustained. Those companies that have relied on borrowing and have debt to service will be particularly vulnerable.

The upshot is that management teams across the world are taking the difficult decision on whether to maintain, reduce or even suspend their regular dividend payments.

We have already seen the impact in the UK, where over 140 companies have announced cuts to their dividends¹. In the US, the futures market is currently predicting a decline of over 25% in the value of dividends paid out by S&P 500 companies in 2020². The picture looks similar across the globe, although the response in Asia has been muted thus far.

In certain countries and industries, the decision has even been taken out of management's hands. The past month has seen governments restricting bank and, more recently, insurance company dividends. Businesses that have taken support – for example, the use of taxpayer money to pay furloughed staff – are being pressured to suspend dividends and other forms of capital return.

As income investors this is clearly a concern, but we are broadly supportive of the measures being taken. Our quality income approach focuses on effective capital allocation. Therefore, a management team taking a prudent approach and conserving cash, even if they can afford the dividend, represents sensible capital allocation given the uncertain operating outlook. Better to cut the dividend now and emerge well-placed on the other side, than risk the alternative.

What has been the impact on yields?

No area of the market has been immune to the crisis, but it has been particularly pronounced in economically-sensitive industries such as financials, resources and consumer cyclicals. These are often home to some of the larger payers, particularly in established dividend markets such as the UK and Australia.

With a global opportunity set, our approach is to have a balanced exposure to different sources of yield to support a stable income profile across market cycles. We group the sources of income as compounders, cyclicals, secular growers and asset-backed names. This tends to remove any reliance on individual industries or regions to drive the yield and results in a more diversified portfolio.

In early 2020, we reduced our cyclical exposure adding more to what we refer to as compounders, stocks that have a steady growth profile and strong cash flow generation. This saw us add to positions in consumer staples and healthcare and reduce our exposure to energy companies – including the full exit of Occidental Petroleum whose dividend has dropped by 86% – well ahead of March's oil price collapse.

We also trimmed our holdings in financials, a sector which, as mentioned above, has been subject to dividend restrictions. Our exposure is now broadly in line with the MSCI ACWI, although we are underweight banks.

So what does this mean for your income?

Having stress-tested each of our holdings for cash flow sustainability, balance sheet strength and available liquidity, we are comfortable with the current portfolio and its ability to deliver an attractive yield for our investors. As the strategy stands today, the 12-month forward yield is 4.6% compared to 2.8% for the MSCI ACWI³.

¹ Source: Columbia Threadneedle Investments.

² Source: Bloomberg, as at 22/4/2020.

³ Source: Columbia Threadneedle Investments / Bloomberg, as at 22/4/2020.

This figure will already account for revised estimates, but what if we were to exclude the bank and insurance dividends of all companies⁴, marking them down to zero? The forward yield would fall to 4.1%⁵. This assumes no repositioning of the portfolio but were we to reallocate capital away from those names at the wider market yield, it would drop to 4.3%⁶.

The sustainability of a company's dividend (ie, adequate dividend cover and a strong balance sheet) is a central tenet of our quality income approach, but in the current environment we think a pragmatic approach makes sense. We will not necessarily reduce or exit stocks that suspend dividends unless we think their position is permanently impaired. This will be done on a case-by-case basis with judgement required on whether this is appropriate capital allocation and on the likely resumption of capital returns.

We continue to find plenty of quality income stocks that enable us to deliver a healthy income for our clients. Indeed, the market selloff means that we now see a number of interesting companies enter our opportunity set. This offers an excellent opportunity to buy high-quality businesses that fit our investment criteria at significantly below their long-term intrinsic value.

Our focus remains maintaining a balance between a healthy dividend yield and a diversified portfolio, without outsized risk concentrations. We think that this approach is in the best interests of our clients.

Summary

We consider dividends, and capital return more generally, to be a signal of investment quality. That becomes even clearer in times of crisis such as this.

Now, more than ever, it is essential that management teams take a disciplined approach to allocating capital. Our preference remains those companies that can deliver a stable and growing dividend over the medium to long term, and that can do so without compromising their balance sheet, the growth potential of the business or indeed their broader social impact.

As our portfolio companies navigate this downturn, we will be closely monitoring them to ensure these qualities hold. We may not necessarily exit those stocks that suspend dividends if we deem it appropriate capital allocation and can see the resumption of capital returns in reasonably short order.

Once the dust has settled, the process of returning capital to investors will likely remain under scrutiny, especially for those companies that have taken government assistance or have been overly aggressive in areas such as balance sheet leverage and capital return. In this new world, we think that genuine dividend sustainability will be more greatly prized.

⁴ Banks and insurance companies represent 9.1% of the portfolio as at 22 April 2020. Note that this is a conservative approach as not all holdings have been impacted by enforced restrictions.

⁵ Source: Columbia Threadneedle Investments and Bloomberg as at 22 April 2020.

⁶ Source: Columbia Threadneedle Investments and Bloomberg as at 22 April 2020.



Important Information. For internal use by Professional and/or Qualified Investors only (not to be used with or passed on to retail clients). Past performance is not a guide to future performance. Your capital is at risk. The value of investments and any income is not guaranteed and can go down as well as up and may be affected by exchange rate fluctuations. This means that an investor may not get back the amount invested. This material is for information only and does not constitute an offer or solicitation of an order to buy or sell any securities or other financial instruments, or to provide investment advice or services. Where references are made to portfolio guidelines and features, these are at the discretion of the portfolio manager and may be subject to change over time and prevailing market conditions. Actual investment parameters will be agreed and set out in the prospectus or formal investment management agreement. Please note that the performance targets may not be attained. The analysis included in this document has been produced by Columbia Threadneedle Investments for its own investment management activities, may have been acted upon prior to publication and is made available here incidentally. Any opinions expressed are made as at the date of publication but are subject to change without notice and should not be seen as investment advice. Information obtained from external sources is believed to be reliable, but its accuracy or completeness cannot be guaranteed. Any opinions expressed are made as at the date of publication but are subject to change without notice. Information obtained from external sources is believed to be reliable, but its accuracy or completeness cannot be guaranteed. This document includes forward looking statements, including projections of future economic and financial conditions. None of Columbia Threadneedle Investments, its directors, officers or employees make any representation, warranty, guaranty, or other assurance that any of these forward-looking statements will prove to be accurate. The mention of any specific shares or bonds should not be taken as a recommendation to deal. This document and its contents are confidential and proprietary. The information provided in this document is for the sole use of those receiving the document. It may not be reproduced in any form or passed on to any third party without the express written permission of Columbia Threadneedle Investments. This document is the property of Columbia Threadneedle Investments and must be returned upon request. This document is not investment, legal, tax, or accounting advice. Investors should consult with their own professional advisors for advice on any investment, legal, tax, or accounting issues relating an investment with Columbia Threadneedle Investments. This document is distributed by Columbia Threadneedle Investments (ME) Limited, which is regulated by the Dubai Financial Services Authority (DFSA). For Distributors: This document is intended to provide distributors with information about Group products and services and is not for further distribution. For Institutional Clients: The information in this document is not intended as financial advice and is only intended for persons with appropriate investment knowledge and who meet the regulatory criteria to be classified as a Professional Client or Market Counterparty and no other Person should act upon it. Issued by Threadneedle Asset Management Limited, registered in England and Wales, No. 573204. Registered Office: Cannon Place, 78 Cannon Street, London EC4N 6AG. Authorised and regulated in the UK by the Financial Conduct Authority. Columbia Threadneedle Investments is the global brand name of the Columbia and Threadneedle group of companies.