

CLIENT QUESTION OF THE MONTH: Is dividend-only stock investing a reliable strategy?

Across the advisor community, we often hear individual investors coming to their advisors infatuated with generating investment returns through high dividend-paying stocks. While this strategy may have been praised by industry experts at one point in time and even today, the data and evidence over the past several decades have shown that there are significant tradeoffs that we believe investors should be aware of when focusing on investing only in firms that pay dividends.

Dividend-paying stocks are sometimes seen as a ballast to a portfolio, particularly during periods of volatility, due to their 'regular' income stream. However, companies paying dividends have the flexibility to cut their dividends and this often coincides with economic downturns. In fact, more than half of dividend-paying firms cut or eliminated those payouts following a financial crisis¹. More recently, in the first three quarters of 2020, dividends from each dollar invested in US markets decreased by 22% compared to the same period in 2019².

For stockholders who own dividend-paying shares, those payments arrive on a schedule (quarterly, in many cases). The cash to fund a dividend must come from somewhere, however. We know the price of a stock is potentially influenced by all expected future cash flows to shareholders. If cash is paid today in the form of a dividend, the stock price—and total market capitalization—of the issuing company may therefore fall, as hypothetical Portfolio A shows in **Exhibit 1** below. That means, all else being equal, an investor who receives a dividend may also be left with a less valuable equity holding.

Exhibit 1

Portfolio A: Income Via Dividends				Portfolio B: Income Via Stock Sale			
Portfolio Ahead of Dividend Payout				Portfolio Ahead of Stock Sale			
Asset	Quantity	Price	Portfolio Value	Asset	Quantity	Price	Portfolio Value
Stock ABC	100	\$20	\$2,000	Stock XYZ	100	\$20	\$2,000
Total			\$2,000	Total			\$2,000
Portfolio After Dividend Payout				Portfolio After Stock Sale			
Asset	Quantity	Price	Portfolio Value	Asset	Quantity	Price	Portfolio Value
Stock ABC	100	\$19	\$1,900	Stock XYZ	95	\$20	\$1,900
Cash			\$100	Cash			\$100
Total			\$2,000	Total			\$2,000

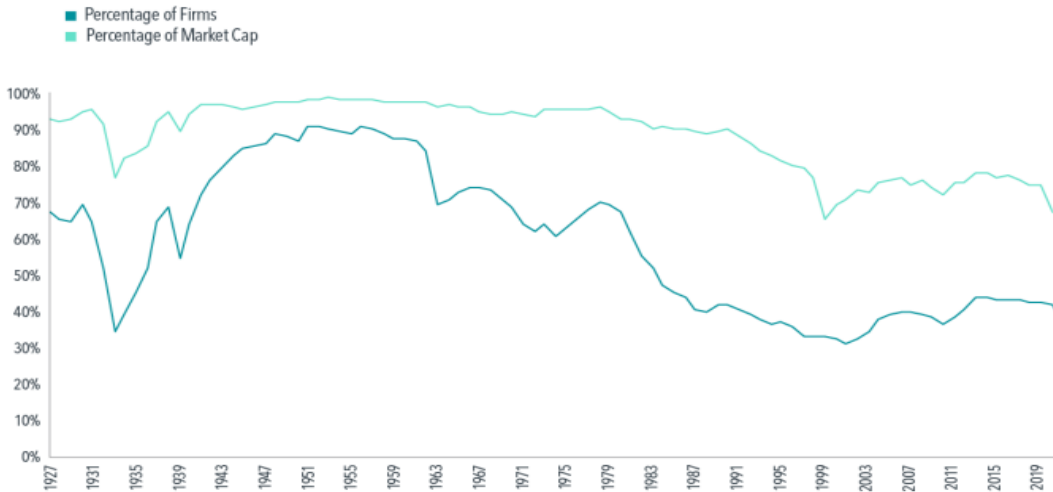
For illustrative purposes only. Assumes the stock price will fall by roughly the amount of the dividend and assumes no nondividend-related price movement.

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It's also important to call out that by focusing on only dividend paying stocks, an investor would be excluding 35-40% of firms from their investible universe³. This choice has a direct effect on the total portfolio's level of diversification. Over the years, we have seen a global decline in the propensity of

firms paying stock dividends out to shareholders. For instance, in 1927, 68% of US companies were paying dividends, while only 38% of firms paid in 2021 as can be seen in **Exhibit 2** below⁴.

Exhibit 2: Annual percentage of firms and market cap that paid dividends in the United States 1921-2021



Source: Fama/French US Portfolios Formed on Dividend Yield. See the Index Description for more information regarding the indices shown.

While we cannot predict what the investing landscape will look like in the future, we can certainly lean on the historical data and trends within the investible dividend universe to make informed asset allocation decisions.

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1: Stanley Black, "Global Dividend-Paying Stocks: A Recent History" (white paper, Dimensional Fund Advisors, March 2013).

2: "Dividends in the Time of COVID-19," Insights (blog), Dimensional Fund Advisors, November 30, 2020

3: Data provided by Bloomberg. The countries are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the Netherlands, the United Kingdom, and the United States

4: Source: Fama/French US Portfolios Formed on Dividend Yield. See the Index Description for more information regarding the indices shown. Provided by Fama/French from CRSP and COMPUSTAT data. Includes all NYSE, AMEX, and NASDAQ stocks for which we have market equity for June of year t , and at least 7 monthly returns (to compute the dividend yield) from July of $t-1$ to June of t . Portfolios are formed on D/P at the end of each June using NYSE breakpoints. The dividend yield used to form portfolios in June of year t is the total dividends paid from July of $t-1$ to June of t per dollar of equity in June of t .