Dividends – Back to the Future

White Paper

Synopsis

- Reinvested dividends have been the dominant contributor to long-term total returns on equity securities
- On average, dividends and dividend growth have provided nearly 80% of a stock's real return beyond 5 years
- Over 101 years such reinvestment in the UK would have produced 108x the wealth generated solely by the same portfolio relying on capital gains
- High dividend yielding stocks have outperformed low yielding stocks across numerous countries
- High dividend yielding stocks are associated with lower overall volatility of returns
- High dividend yielding stocks exhibit lower downside volatility relative to non-dividend yielding stocks
- In declining markets, high dividend yielding strategies have also outperformed other value strategies, as well as the market overall
- Dividends are a 'bear market protector': they cushion the fall in the value of a stock during declining markets
- During bear markets, dividend income reinvested at lower stock prices can enhance future returns. Once prices turn higher these reinvested dividends become a 'total return accelerator'
- Empirical evidence suggests that companies with consistent dividend policies tend to have better total return performance than those without
- Dividends have helped investors in both inflationary and deflationary times

*"Compound interest is the eighth wonder of the world.
He who understands it, earns it ... he who doesn't ... pays it."*

Einstein

DIVIDENDS – BACK TO THE FUTURE

"It was never my thinking that made the big money for me.
It was always my sitting."

Jesse Livermore, Legendary stock investor

"Do you know the only thing to give me pleasure?
To see my dividends coming in."

John D Rockefeller, Very wealthy man

Since the 2008 crisis, governments and monetary policymakers have collectively embarked on a form of debt restructuring called financial repression, whereby central banks maintain short-term interest rates below the natural market rate and purchase government bonds to suppress long end rates. Governments encourage such activity so that they can continue to fund their fiscal needs at affordable borrowing rates. Likewise, they have encouraged regulation which coerces domestic capital to invest in domestic government debt.

Such fiscal domination may have potentially disastrous consequences long-term. The coercive behaviour of policymakers has driven long end rates too low and real rates negative for too long, the upshot of which is investors have embarked on ever riskier investments. Significant beneficiaries have been the equity markets and higher yielding bond sectors. Unfortunately, some equity indices and sectors have begun to exhibit excessive multipleexpansion, which will require significant earnings growth in years to come to support such values. Similarly, right across the credit spectrum yields do not reflect the diminishing quality, hence investors have exposed themselves to greater risk.

Investors have begun to believe the world economy, certainly the developed world, is on the brink of a normalisation in economic behavior, reinforced by the belief that the shale oil revolution will supply the world with everlasting "cheap" energy and seemingly diminished geopolitical risk in the Middle East will mean lasting peace. The consensus is that bond rates will normalise, equities will rise uniformly across the globe and rising nominal GDP growth will reflect the growth in real earnings and a safer world. We take a slightly less rosy view and see a global economy that has become too reliant on state intervention and ultra-loose monetary policy, whereby any transition to higher rates from a boycott of bonds either by market participants or policymakers will lead to heightened volatility across asset classes. Geopolitical risks never go away completely and will continue to have a meaningful impact on asset class performance from time to time.

Importantly, low long end yields, negative interest rates, rising asset classes, the potential for growth to slow, coupled with structurally lower employment and an aging demographic in the developed world has focussed investors' minds on the need for income and capital preservation.

Robust dividend strategies can help investors meet these long-term needs, and help their portfolios navigate both depressed markets and exuberant ones. Using the Hinde Dividend Value Matrix™, we identify common, dividend-paying stocks which exhibit the propensity to sustain and grow their dividends, but which are undervalued relative to the overall market based on their fundamental growth momentum and total return potential. By using a beta index hedge, we have also been able to secure more stable, higher long-term returns, with lower drawdowns relative to a long-only basket of dividend stocks based on an 11 year back-test.

If an investor is looking for growth, income and safety then an equity dividend strategy like the Hinde Dividend Value Strategy will meet those requirements. A dividend yield strategy is a systematic methodology to select stocks that pay dividends which are high in relation to their stock prices.

Executive Summary

Many investors seek out income paying stocks simply because their yields are attractive compared with zero bank savings rates and the negative real yields achievable on fixed income assets. Whilst most investors see the short-term yield pickup potential, many have not fully appreciated the power of dividends to provide long-term, real total returns.

The impact of dividends on equity portfolios has not diminished for decades, even centuries. It is only the whims and fads of investors that change. The tantalizing proposition of wealth changing returns from stocks offering the latest new thing has enticed many investors to risk too much in speculative ventures over the years (think Dot Com bubble). The casualty of this interest is, invariably, a disinterest in dividend-paying stocks, considered boring and unsexy. In the short-term, dividend paying stocks are almost always boring, but in the long run the power of dividends is very sexy.

Zero interest rates have re-focused investors' minds on the importance of income needs but the simple truth is that dividend-paying stocks have for generations offered a gradual, but potent, contribution to long-term total returns, whilst mitigating the effects of unfavourable markets and inflation. This is the overriding message for investors as to why they should invest in dividends, but there are many other attractive qualities, which we explore in this piece, that make dividend-paying stocks oh so sexy:

What are Dividends?

A dividend is the distribution of a portion of a company's real earnings to a class of shareholders. It is quoted as a currency amount per share which is referred to as a dividend yield when quoted as a percentage of the company's stock price.

In William Thorndike's book 'The Outsiders - Eight Unconventional CEOs and Their Radically Rational Blueprint for Success' he examines one of the most important aspects of running a business a CEO must undertake: capital allocation. He summarises how a CEO deploys capital in order to best utilise cash flow generated from his or her business operations. Essentially, CEOs have 5 ways of deploying capital:

- Investing in existing operations
- Acquiring other businesses
- Repaying debt
- Repurchasing their own stock (buybacks)
- **Paying dividends**

Alternatively, they could leave surplus cash on their balance sheet, but the long-run success of a company that seeks only to compound cash could be compromised. Likewise, large shareholders will subject a company to a return expectation which is higher than the available savings rate. A company must 'hurdle' this rate to satisfy shareholders they are allocating capital efficiently in order that the best long-term return on capital is offered without compromising the success of the business. Shareholders clearly don't invest in companies to be a savings deposit account over the long run and dividend payments are a way of rewarding long-term shareholders for the risk of holding a company's stock.

The choices a CEO makes provide helpful information to shareholders about a company's growth prospects and stability. Younger companies tend to reinvest cash into their business as they are still in the growth stage, whereas well-established, mature companies that have achieved more stable and less volatile cash flows will usually pay out dividends and/or buyback stock.

Similarly, dividend policies will vary across industries. For example, those of a capital intensive nature, such as heavy manufacturing, construction and airlines often have to reinvest their cash in existing operations to maintain their business models consequently a dividend is rarely paid, whereas companies in industries that support stable cash flows, such as utilities and telecommunications, will tend to pay out consistent dividends.

The Power of Dividends

Over the long run, dividends pay handsomely when reinvested, but even after relatively short periods of time, such as 5 years, the compounding effects of reinvestment start to have a measurable impact.

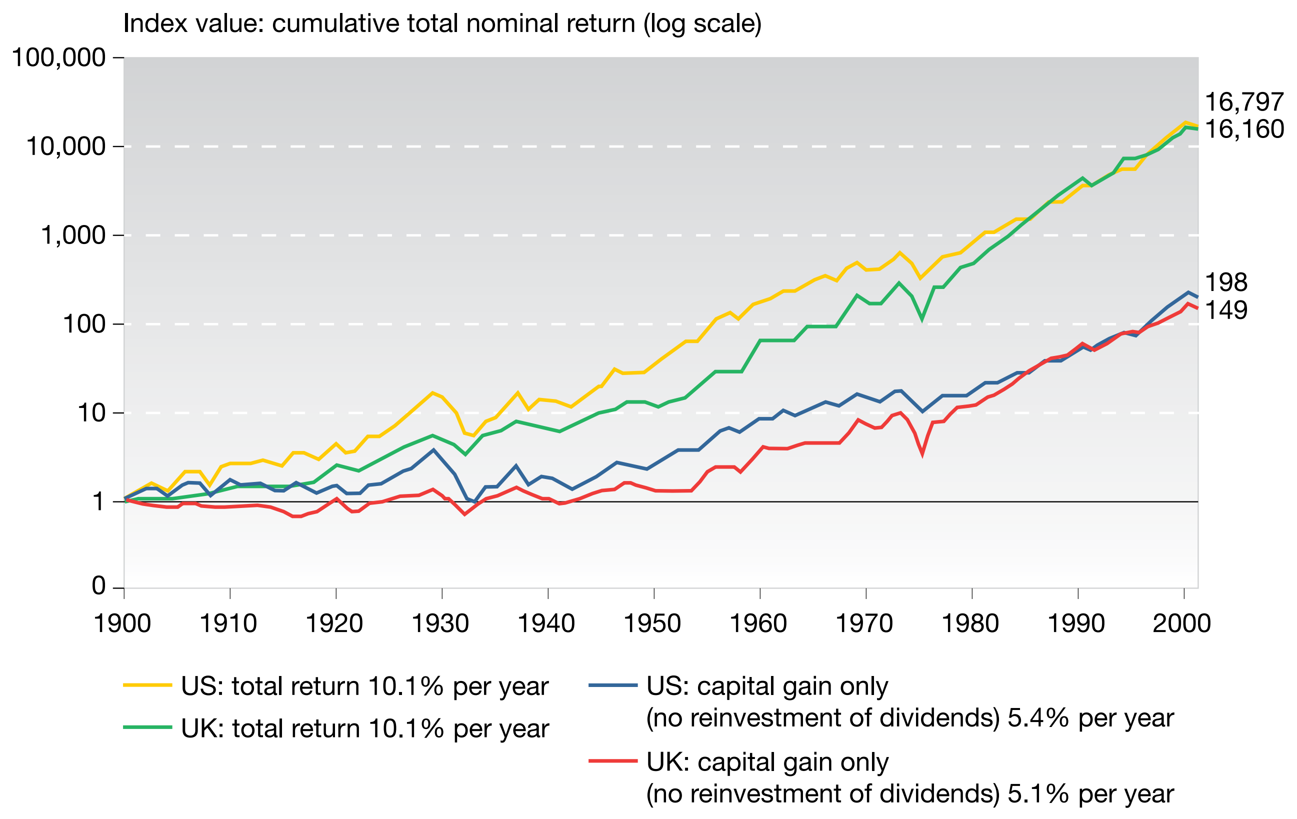
Historical Perspective

If £100 had been invested in 1900 with all dividends reinvested thereafter, by the year 2000 it would have been worth £1,616,000 compared with only £14,900 if no dividends had been reinvested.

This was the conclusion of Elroy Dimson, Paul Marsh and Mike Staunton in their book 'Triumph of the Optimists: 101 years of Global Investment Returns':

- Reinvested dividends have been the dominant contributor to long-term total returns on equities
- Dividends and dividend growth have, on average, provided nearly 80% of a stock's real return beyond 5 years
- Over 101 years, such dividend reinvestment in the UK would have produced 108x the wealth generated from the same portfolio relying solely on capital gains

IMPACT OF REINVESTED DIVIDENDS ON CUMULATIVE US AND UK EQUITY RETURNS 1900 - 2000

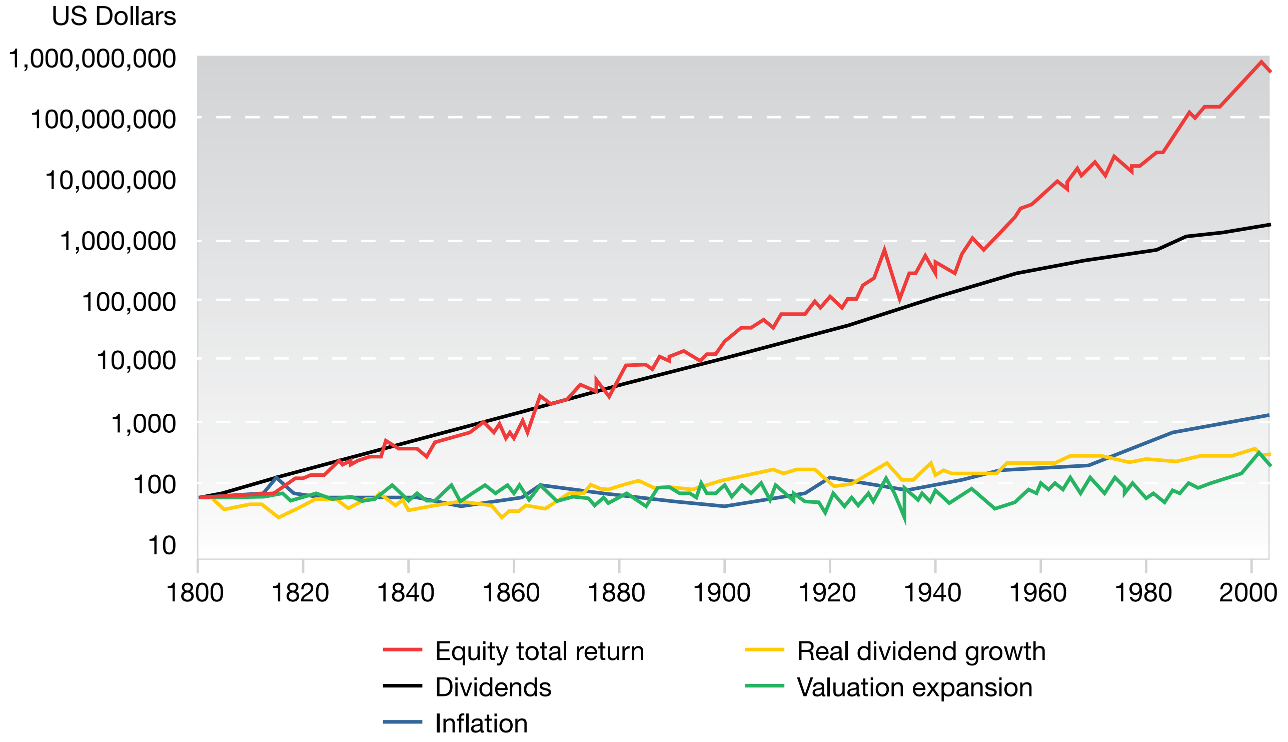


Source: Triumph of the Optimists, Dimson, Marsh and Staunton

In a later research piece, ‘The Worldwide Equity Premium: A Smaller Puzzle’, covering the period from 1990 to 2005, Dimson et al noted this phenomenon held true for other equity markets around the world. The real return across the seventeen countries studied averaged approximately 5%, whilst the average dividend yield of those countries during the period was 4.5% (Dimson et al, 2006)

In ‘Dividends and the Three Dwarfs’, Robert D. Arnott also exposes the true power of dividends. He points out that from 1802 to 2002, dividends were, by far, the main source of real return from equities, dwarfing the other constituent sources, including inflation, rising valuation and real dividend growth. According to his calculations from 1802 to 2002, the average annual return from equities was 7.9%, of which 5.0% came from dividends, 1.4% from inflation, 0.8% from real dividend growth and 0.6% from rising valuations. The numbers show that 63% of the total return from equities has come from dividends and 73% from the combination of dividends and dividend growth. The author’s conclusion: ‘Unless corporate managers can provide sharply higher real growth in earnings, dividends are the main source of real return we expect from stocks.’

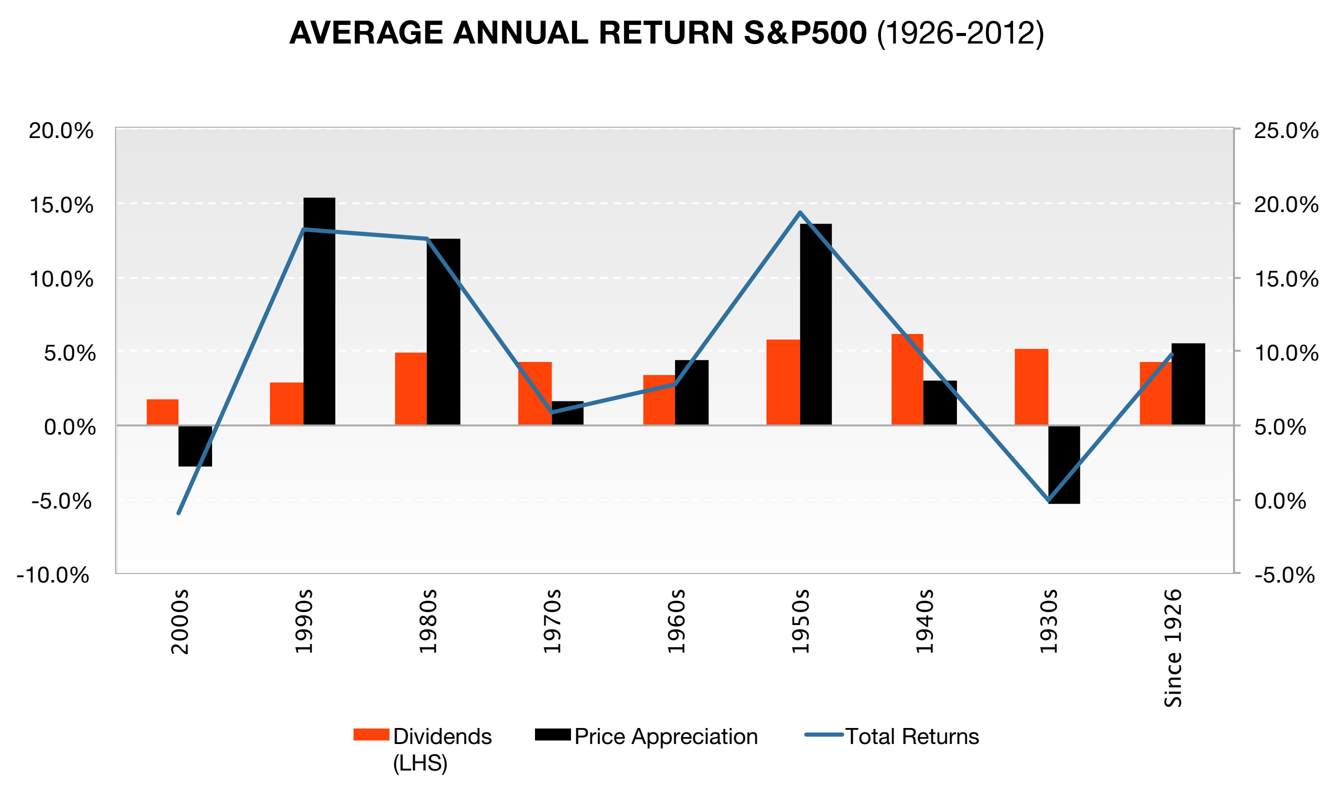
DIVIDENDS AND THE THREE DWARFS:
GROWTH OF $100 INVESTED IN US EQUITIES, 1802 – 2002



Source: Robert D. Arnott, ‘Dividends and the Three Dwarfs’

10 year Return Horizons

Examining returns over the past century, broken down by decade, enables us to study periods more in keeping with a typical investor's time horizon. The chart below of the S&P500 highlights the respective contributions of dividends and capital returns (price appreciation) by decade. In severe bear markets, such as the 1930s and 2000s, dividends helped to offset the capital losses; in decades with modest capital returns, they clearly boosted total returns significantly.

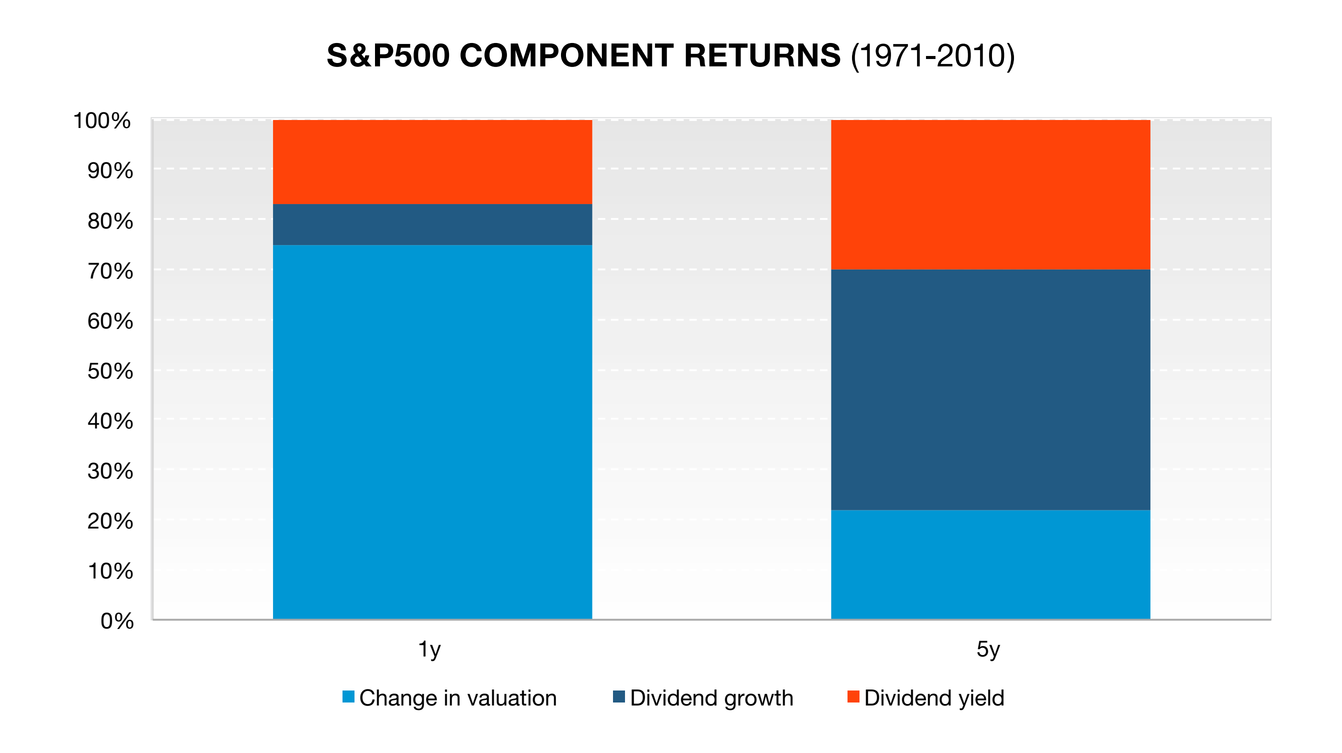


AVERAGE ANNUAL RETURN S&P500 (1926-2012)	Dividends	Price Appreciation	Total Returns
2000s	1.77%	-2.72%	-0.95%
1990s	2.89%	15.32%	18.21%
1980s	4.95%	12.59%	17.55%
1970s	4.25%	1.60%	5.86%
1960s	3.41%	4.39%	7.81%
1950s	5.77%	13.56%	19.35%
1940s	6.18%	2.98%	9.71%
1930s	5.21%	-5.27%	-0.05%
Since 1926	4.28%	5.56%	9.84%

Source: CRSP Database

1 year and 5 year Return Horizons

Observing shorter holding periods of 1 and 5 years, we see that dividends typically account for only 20% of stocks' total return in year one, but by year 5 they account for almost 80% of the total return ('A Man from a Different Time', James Montier).



Source: GMO, A Man from a Different Time, James Montier, Aug 2010

Unsurprisingly, the best way of achieving returns comparable to those shown in some of these longer term studies is to hold stocks for the longer term! Nowadays, the average stock holding period is sadly just 8 months, perhaps a reflection of investors' short-term pursuit of a 'fast buck', encouraged by the ease of the 'click' world we inhabit, along with the culture of 24/7 financial news reporting.

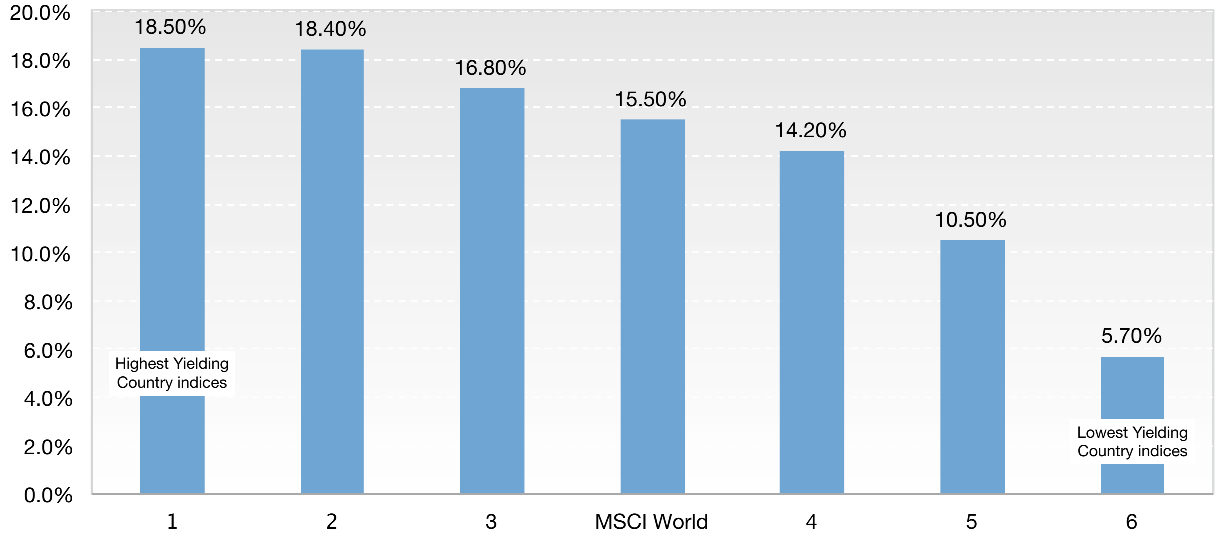
For once, past performance is a predictor of likely future returns: the power of dividend reinvestments almost ensures consistent returns over time because of the effects of compounding. It's irrefutable mathematics.

The Yield Advantage

High dividend yielding stocks provide better risk attributes than non-yielding stocks.

- High dividend yielding strategies have outperformed low yielding stocks across 18 developed countries, according to Kepper in his study entitled 'The Importance of Dividend Yields in Country Selection', The Journal of Portfolio Management 1991.

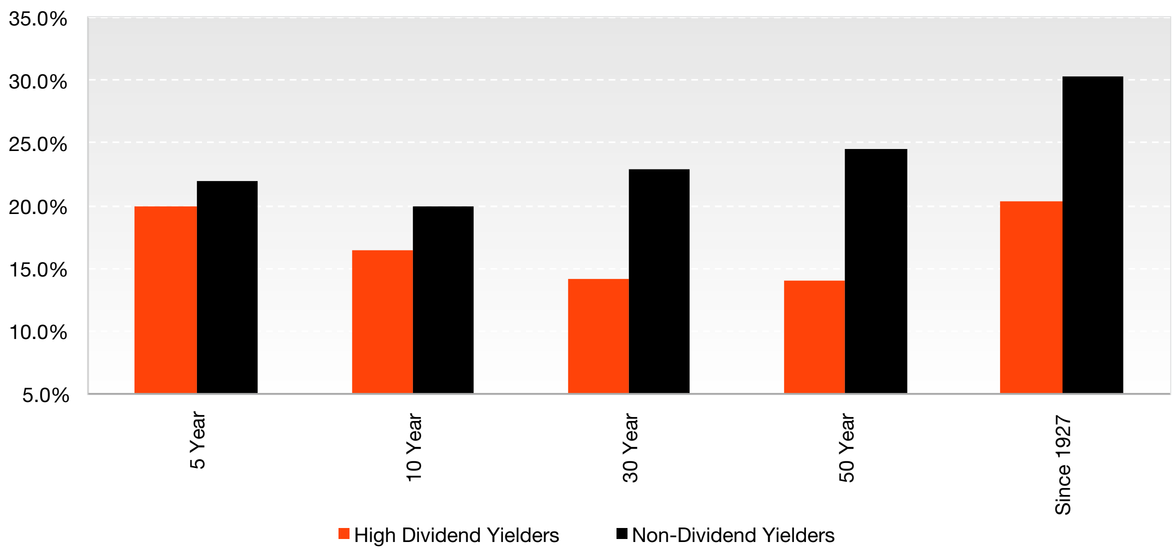
COMPOUND ANNUAL RETURNS (LOCAL CURRENCY) BASED ON VARIOUS DIVIDEND YIELD STRATEGIES AND THE MSCI WORLD INDEX DEC 1969 – DEC. 1989



Source: The Importance of Dividend Yields in Country Selection, A Michael Keppler, 1991

- High dividend yielding stock strategies are also associated with lower volatility of returns.

STD DEV. OF HIGH-DIVIDEND YIELDERS VS NON DIVIDEND YIELDERS (1927-2011)

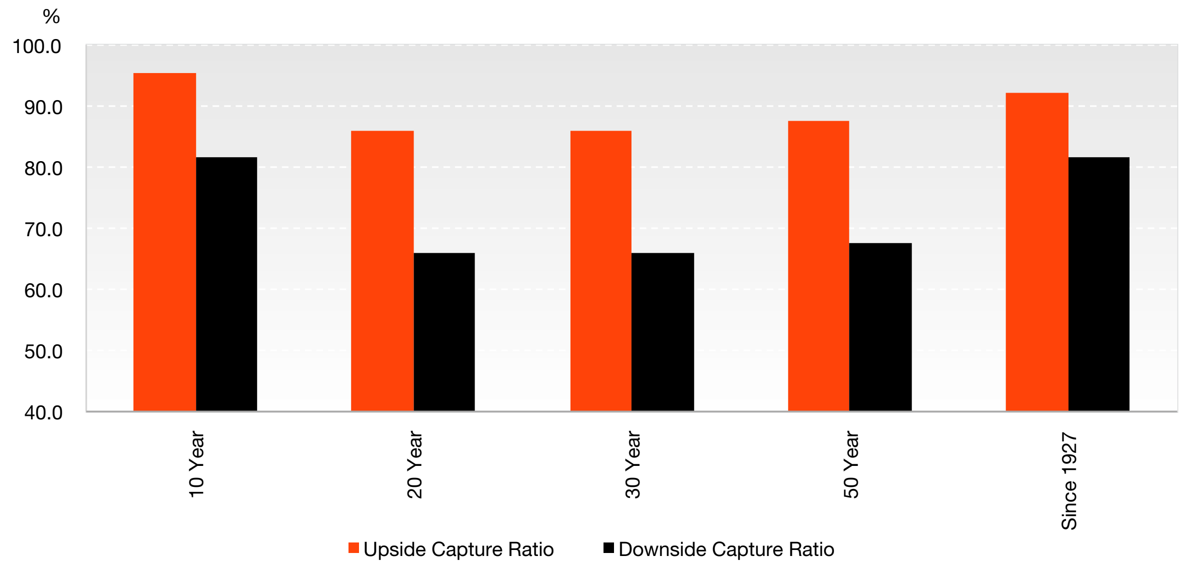


Source: Kenneth French, CRSP and DWS

- Downside protection: an attractive characteristic of high-dividend paying stocks is their reduced downside volatility.

During periods when the S&P500 has declined, dividend paying stocks have declined by nearly 19% less than the broader market. This enhanced 'downside protection' has occurred across many global equity indices. However, high dividend yielding strategies have also managed to capture most of the upside in rising markets.

DOWNSIDE AND UPSIDE CAPTURE RATIOS OF HIGH DIVIDEND YIELDERS (1927-2011)



Source: Kenneth French, CRSP and DWS

Downside Capture ratio measures a portfolio's performance in declining markets relative to the investment universe: the lower the Downside Capture ratio, the better the portfolio performed during a market downturn. Upside Capture ratio measures a portfolio's performance in rising markets relative to the investment universe: the higher the Upside Capture ratio, the better the portfolio performed during a market upturn.

- High dividend yielding strategies have also tended to outperform other value strategies in declining markets.

According to David Dreman, in his book 'Contrarian Investment Strategies: The Next Generation', the performance of a dividend strategy versus 3 value strategies (low price-to-earnings, low price-to-book and low price-to-cashflow) covering 1,500 companies and spanning a 27 year period from 1970 to 1996 was at least 2% higher and, overall, lost around half as much as the stock market during down quarters.

Bear Market Protector

The risk/return profile of dividend-paying stocks is a function of the reinvestment of income into stocks at lower prices.

In his book 'The Future for Investors', Dr. Jeremy Siegel, an acclaimed finance professor from Wharton Business School, observed the performance of US stocks from 1957 to 2002 and showed how dividends help an investor's portfolio in declining markets. Dividend payments are more stable than valuations across a market cycle, and so become a more important component of total return in declining or stagnant markets.

If the same dividend amount continues to be paid (which tends to be the case) after a stock has fallen in price, the investor will receive a greater number of shares upon reinvestment of that income than if the share price had not fallen. This is why Siegel refers to dividends as the 'bear market protector': they cushion the fall in the value of the stock.

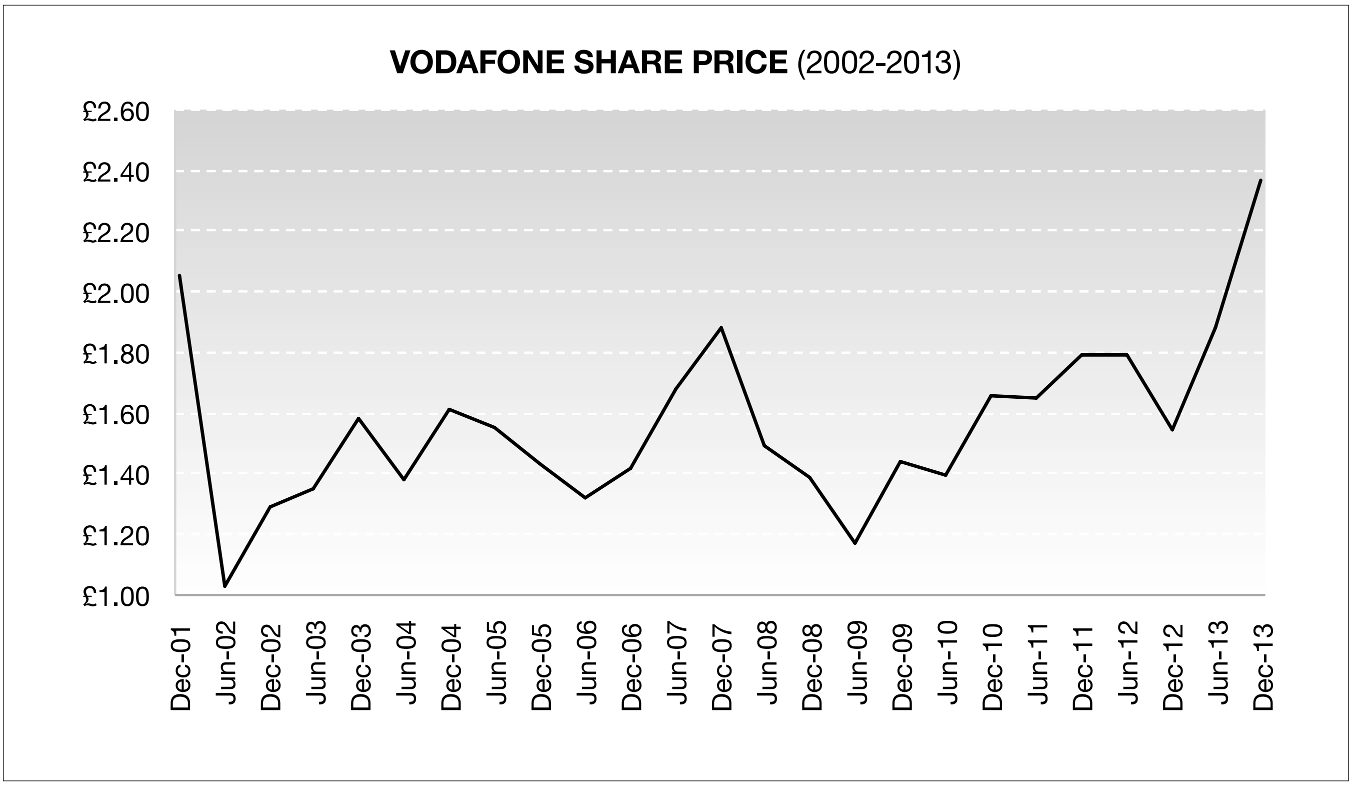
Total Return Accelerator

Crucially, however, once that income has been accumulated in shares at lower prices it can enhance future returns: as prices turn higher those reinvested dividends now turn into a 'total return accelerator'.

The reinvestment of dividends from higher yielding stocks relative to the overall market index dramatically reduces the time needed to recoup losses experienced during declining markets. Dividend stock investing is truly a 'Back to the Future' investment strategy: when stocks bounce back you make greater total returns and today people are turning back to this age old method for future returns.

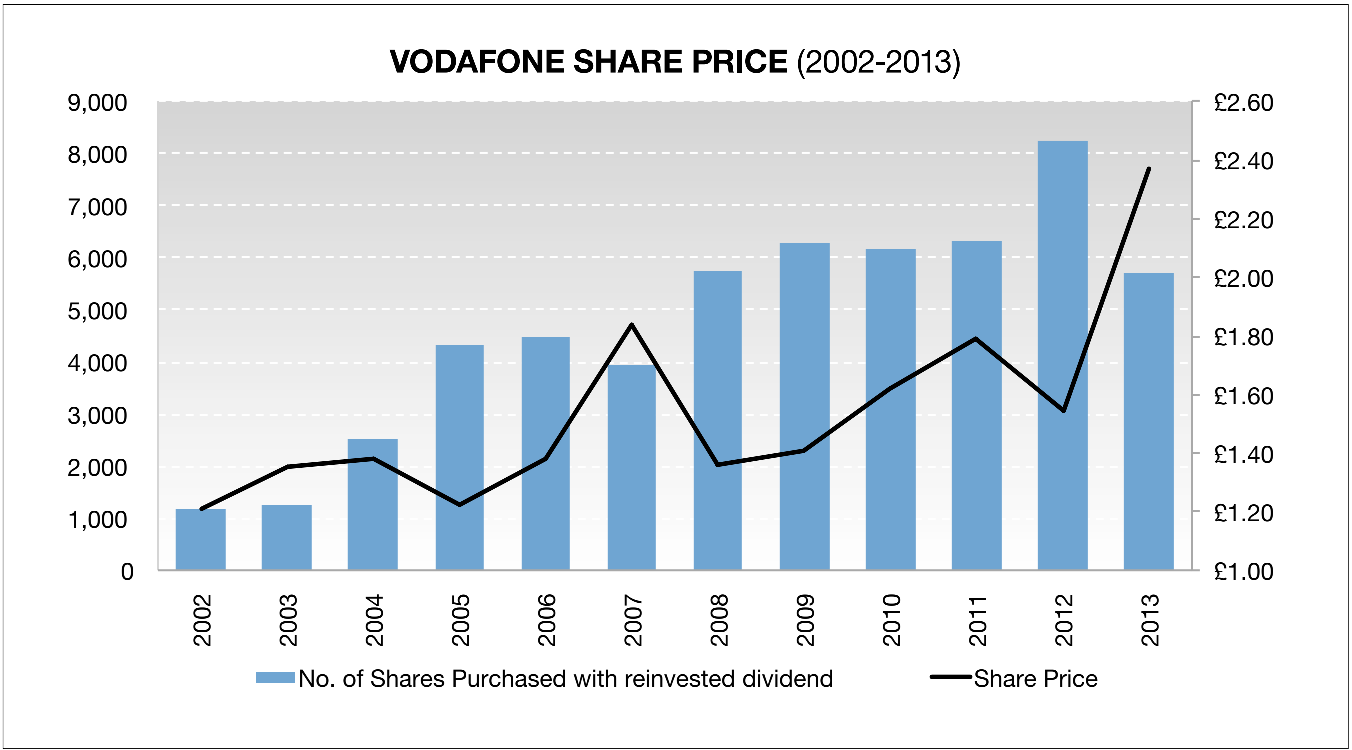
We love the dividend companies we hold to decline in value, whilst maintaining their overall fundamental soundness, because we get to reinvest in more of our favourite companies.

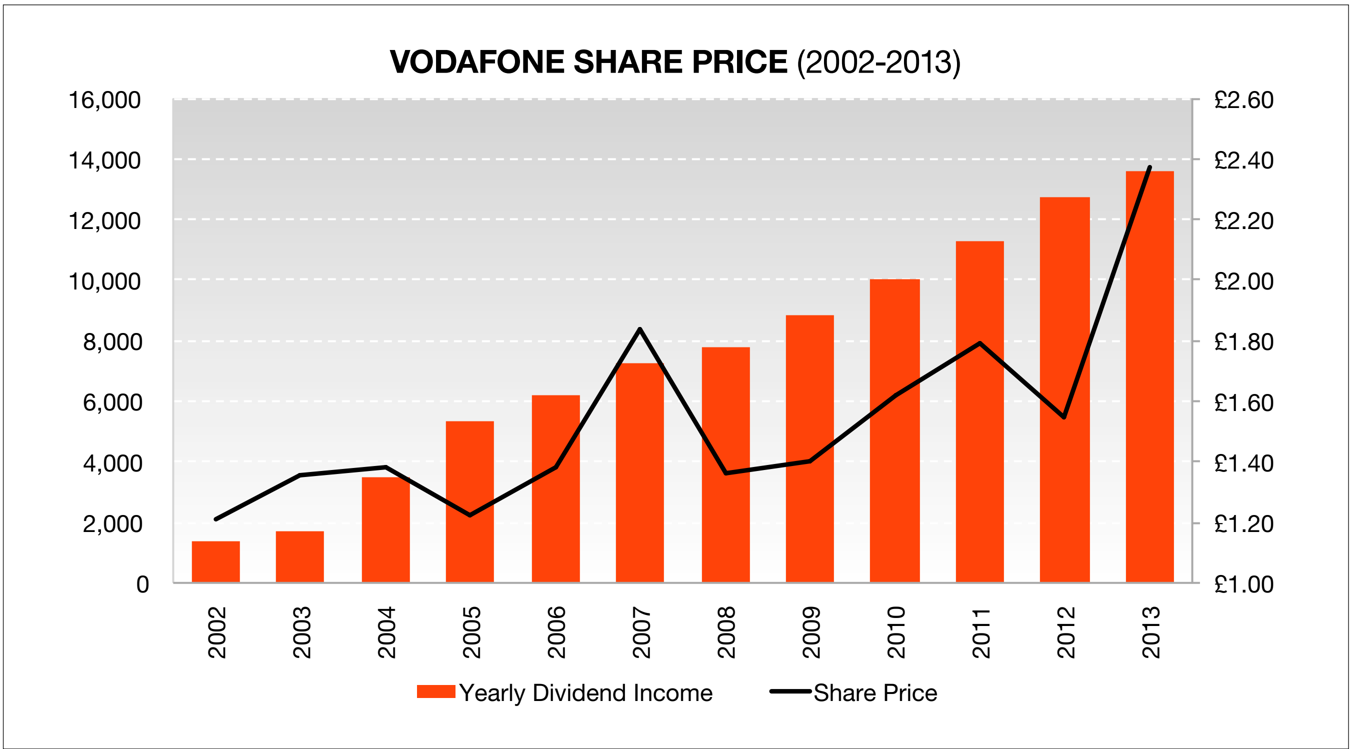
Let's take a look at Vodafone, a telecoms company. Each year, for the past thirteen years, Vodafone has increased its dividend payment. Investing £100,000 at the end of 2002, we would have been able to buy 82,712 shares. We can also work out how many shares we would have subsequently been able to accumulate by re-investing all dividend proceeds. The following charts show the share price performance of Vodafone over this period and illustrate how our shareholding would have grown with the reinvestment of all dividends received during the period.



Several observations can be made from the charts below. Firstly, Vodafone's dividend per share rose each year. Secondly, the number of Vodafone shares we would have held went up throughout the holding period from our initial purchase of 82,712 shares in 2002 to 138,903 shares at the end of 2013. Finally, the number of shares we would have bought with our re-invested dividends varied between 1163 shares in 2002 and a high of 8240 shares in 2012.

Without doubt, the fall in Vodafone's share price during the 2008/9 sell off would have been hard to stomach if you happened to be regularly monitoring your account valuation at that time. However, you were able to benefit from purchasing the greatest number of 'additional' shares using your dividend income in those years. The compounding benefit of buying those shares at far lower valuations continued between 2010 and 2013 (and would likely carry on long into the future if you were to continue to hold the shares), as the greater share balance provided a higher amount of income in the subsequent periods. This is another example of how dividends and dividend re-investments can generate significant compounding effects.





A Signal of Health

When a "firm has adopted a policy of dividend stabilisation with a long-established and generally appreciated 'target payout', investors are likely to (and have good reason to) interpret a change in the dividend rate as a change in the management views of future profit prospects for the firm."

'Dividend Policy, Growth and the Valuation of Shares', Miller and Modigliani, 1961

First and foremost, dividends are paid from a company's operating cash flow rather than its earnings. Due to a myriad of accounting rules, earnings can be (and often are) manipulated to show the picture a company's management wants to paint. Companies with regular dividend policies tend to offer more transparency.

Companies that pay regular dividends and that have long histories of paying consecutively over successive years (even better are those with a history of growing their dividend payments) are likely to continue to do so in the future. Management which adhere to such a dividend policy will usually seek to maintain their dividend payout before deciding how best to use the rest of the free cash flow. This is a useful indication of a fiscally disciplined company and a signal of overall balance sheet health, as such companies tend to generate and distribute cash flow in a sustainable manner. They tend also to be sensibly financed and to allocate capital with a focus on long-term returns for shareholders.

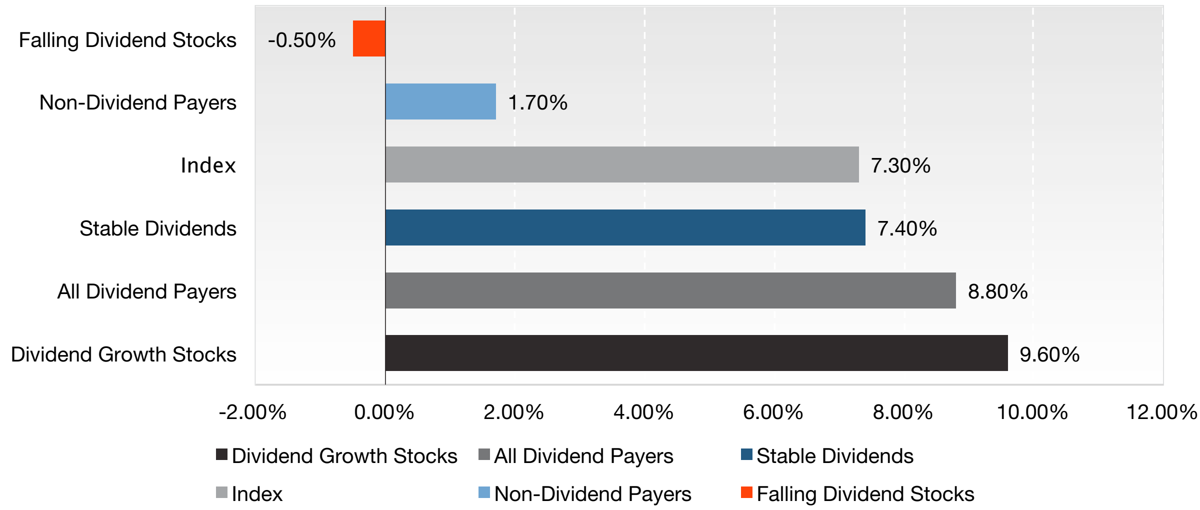
Regular dividend payments exert financial discipline on management. They also increase accountability, for if management wants to embark on large-scale investment they will likely have to seek financing from external debt or equity; such investment will tend to be productive in nature in order to maintain dividend payments. Overall, a commitment to pay regular dividends tends to ensure not too much debt is employed and that cash does not sit idly on the balance sheet tempting managers to embark on riskier ventures, such as ill-advised merger and acquisitions.

Growing dividend payments signal management confidence in the profitability of the business and help align the interests of management with those of its shareholders, assuming management is paid in restricted stock and not stock options, so that their compensation is linked to shareholder total returns rather than to stock options which don't confer a dividend right.

A survey of chief financial officers (CFOs) conducted by Brav et al, 'Payout Policy in the 21st Century', 2005 revealed that firm payout policies tended to be conservative and CFOs would avoid having to cut dividends for fear of triggering a negative reaction from shareholders. Likewise Daniel et al. in 'Dividends, Investment and Financial Flexibility', 2007 provided evidence that companies would prefer to reduce investment rather than dividends.

There is strong empirical evidence from Ned Davis Research that a company with a strong dividend policy has a better total return performance than one without:

ANNUALISED TOTAL RETURN OF DIVIDEND-PAYING STOCKS COMPARED TO DIVIDEND-CUTTING STOCKS: (S&P 500 1972-2010)



Source: Kenneth French, CRSP and DWS

‘Flation Protection

Over the course of the past century inflation has been a major economic force and all investment returns clearly need to be adjusted for it.

In the US and UK, the compound effect of inflation from 1900 to 2000 was a factor of 24x and 55x, respectively. However, prices did not rise uniformly throughout this period, as there were periods of extreme deflation during the 1920s and 1930s, but since then monetary policy has continued to inflate prices. After 2008, it is clear we cannot ignore either ‘flation fears. Inflation can turn into deflation very quickly and vice-versa.

Inflation

Let us consider total stock returns, earnings and dividends growth in differing inflation regimes. The historical dataset provided by Deutsche Bank and JP Morgan shows equities have performed best when inflation is between -3% and +3% (as measured by the Consumer Price Index - CPI).

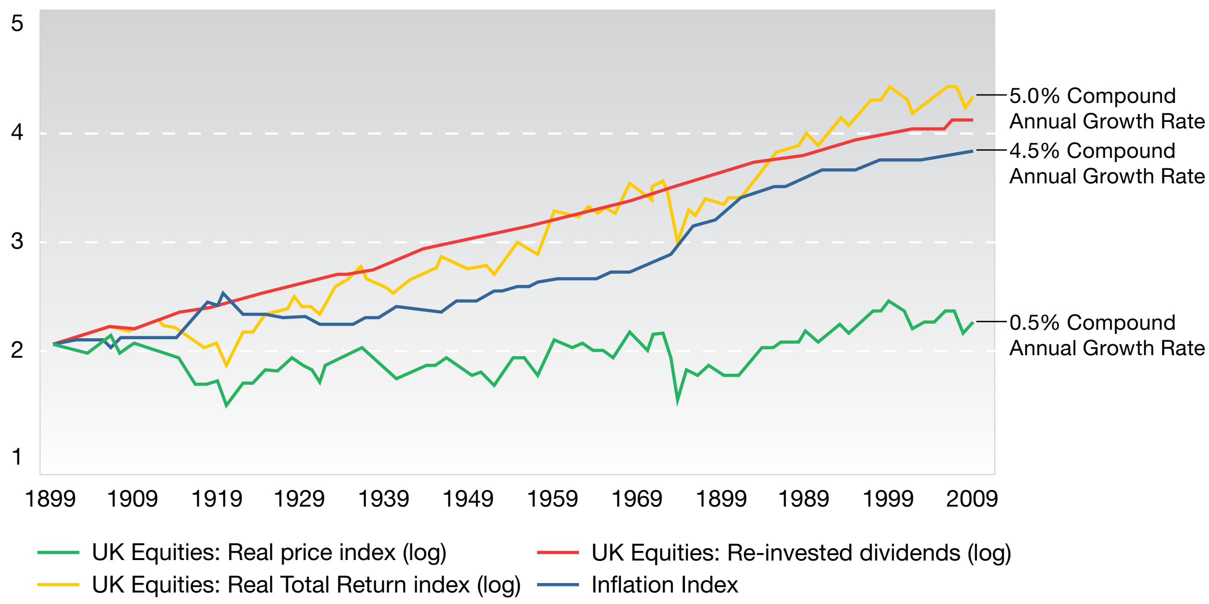
AV. ANNUAL US EQUITY RETURNS OVER VARYING INFLATION REGIMES (1872 - 2009)

Year-on-Year CPI growth	% time occurred	Year-on-Year S&P500 Index Growth
From 15% to Plus	3.00%	-6.30%
From 8% to 15%	7.00%	5.60%
From 5% to 8%	14.00%	0.30%
From 3% to 5%	17.00%	2.40%
From 1.5% to 3%	21.00%	10.70%
From 0% to 1.5%	15.00%	7.70%
From -3% to 0%	9.00%	15.40%
From -10% to -3%	12.00%	1.90%
From -15% to -10%	3.00%	-0.90%

Source: Deutsche Bank, JPM

Observing UK equities over a 100 year period, we see that dividend income has tended to grow faster than inflation more often than not.

UK EQUITY RETURNS: PRICE, DIVIDENDS AND INFLATION CHANGES



Source: Barclays Capital UK Equity Gilts Study

It is clear that dividends have tended to grow more than equity prices in inflationary periods. This is the impact of nominal price rises: companies tend to raise the price of their products before increasing real wages, thus maintaining or increasing margins and their ability to raise dividends.

US EQUITY PERFORMANCE IN PERIODS OF HIGH INFLATION (>5%)

Inflation period	S&P500 Index Return	Earnings Growth	Dividend Growth	P/E Ratio Growth
May 1872 - November 1872	-4.0%	4.0%	9.0%	-8.0%
October 1879 - September 1890	23.0%	28.0%	26.0%	-4.0%
August 1881 to August 1882	-3.0%	-6.0%	8.0%	3.0%
January 1893 to June 1893	-16.0%	-15.0%	2.0%	-2.0%
June 1899 to August 1900	-4.0%	19.0%	32.0%	-19.0%
April 1902 to March 1903	-1.0%	14.0%	4.0%	-13.0%
October 1906 to October 1907	-34.0%	-8.0%	13.0%	-28.0%
February 1909 to July 1910	-5.0%	25.0%	13.0%	-24.0%
April 1912 to February 1913	-4.0%	11.0%	2.0%	-13.0%
March 1916 to November 1920	-19.0%	-18.0%	13.0%	-1.0%
August 1941 to September 1943	17.0%	-4.0%	-13.0%	22.0%
July 1946 to October 1948	-13.0%	155.0%	31.0%	-66.0%
December 1950 to December 1951	18.0%	-13.0%	-1.0%	35.0%
March 1969 to January 1971	-8.0%	-11.0%	1.0%	4.0%
April 1973 to October 1982	18.0%	95.0%	116.0%	-39.0%
August 1990 to February 1991	1.0%	-2.0%	3.0%	3.0%
Median	-4.0%	1.0%	8.5%	-6.0%

Source: Deutsche Bank, JPM

Deflation

In an era of unprecedented monetary largesse, the immediate conclusion most make is that we will experience higher inflation. Of course, it is most likely true that asset class prices would have been much lower had we not seen excessive money printing (we do not imply this is a good thing, merely an observation). However, the longer term consequences of such unconventional monetary policies remain to be seen.

If the multiplier effect from the use of money as credit takes hold, with capital investment having taken a back seat these past 5 years, we could experience a sudden rise in CPI prices. Conversely, should money and credit contract, as money printing remains merely on hold, we may well observe a fall in prices across assets and goods sold. This would reflect a disinflationary, potentially even deflationary scenario.

Deflation reduces overall corporate profitability as the real cost of capital rises and wage rigidity tends to keep costs higher relative to output prices. Likewise, consumers tend to reduce spending creating a negative feedback mechanism of lower growth, lower prices and, initially, lower profits in the economy.

In such an environment, a company with firm pricing power, an unlevered balance sheet and a long-term asset base, i.e. a defensive company, will tend to outperform. In times of uncertainty, investors will generally seek the refuge of stable, long-term dividend payers as these traits tend to signal fiscal health.

Yield Traps

Since the crisis, many investors have rediscovered the potential of income paying stocks.

Many observe a yield in excess of money-market returns in companies they associate with stability and so invest seeking this 'safe' income. Others invest in higher yielding companies, overlooking the risk potential of dividend cuts or a company's ongoing viability. Such investors are in danger of chasing yield. We refer to this as 'chasing the dragon', i.e. seeking returns with diminishing risk reward. In doing so, investors risk falling into yield traps.

Dividend yield is a value metric: as price falls the yield rises as a function of the price-to-dividend ratio. A yield trap is a type of value trap. Any stock with a yield excessively higher (measured in standard deviations) than its sector and index average should throw up a warning signal, a red flag that all is not quite right. Yield spells risk, a risk that the company will not be able to sustain dividend payments or, even worse, that the financial viability of the company is in question. A sustained drop in earnings usually foreshadows a dividend cut, but yield traps can creep up on an investor. Often dividends are shaved as earnings deteriorate, which has the effect of increasing the yield only modestly as the stock falls and masks the usual flag that a sudden, higher yield would 'wave' were such a stock to decline in price swiftly. Invariably, the payout ratio (the percentage of a company's earnings that are represented by dividend payments) increases. This could be a clear red flag, but as dividends are paid from a company's cash flow, not its operating earnings, this may be an unreliable flag all the same.

The yield trap explanation helps explain why the very highest yielding companies in a number of studies have not provided the best overall returns; it is usually the second highest yielding quintile or decile companies which have done so. This is intuitive, as many companies who end up in the highest yielding group will often be unable to sustain their dividends at current rates and will have to make a dividend cut, or worse, they will be about to declare bankruptcy.

Any strategy that invests solely in high yielding companies and that does not take into account a myriad of fundamental factors is likely to be heavily concentrated and exposed to losses relative to the overall market. Owning high yielding banking stocks in 2008, for example, would have resulted in investors severe capital losses as many cut dividends and, in some cases, were then declared bankrupt, albeit bailed out by the state.

In extreme market conditions, companies who regularly pay dividends tend only to reduce their payments in aggregate, with only a few individual names stopping payments altogether. This is because such companies have tended to be fiscally prudent and their dividend policies are a long term reflection of their real earnings capabilities; payout ratios have been set at levels which are sustainable albeit with minor dividend reductions becoming necessary in extreme periods of company and/or economic turmoil.

S&P500 DIVIDEND PER SHARE AND EARNINGS PER SHARE FALLS FOR THE LAST 5 US RECESSIONS

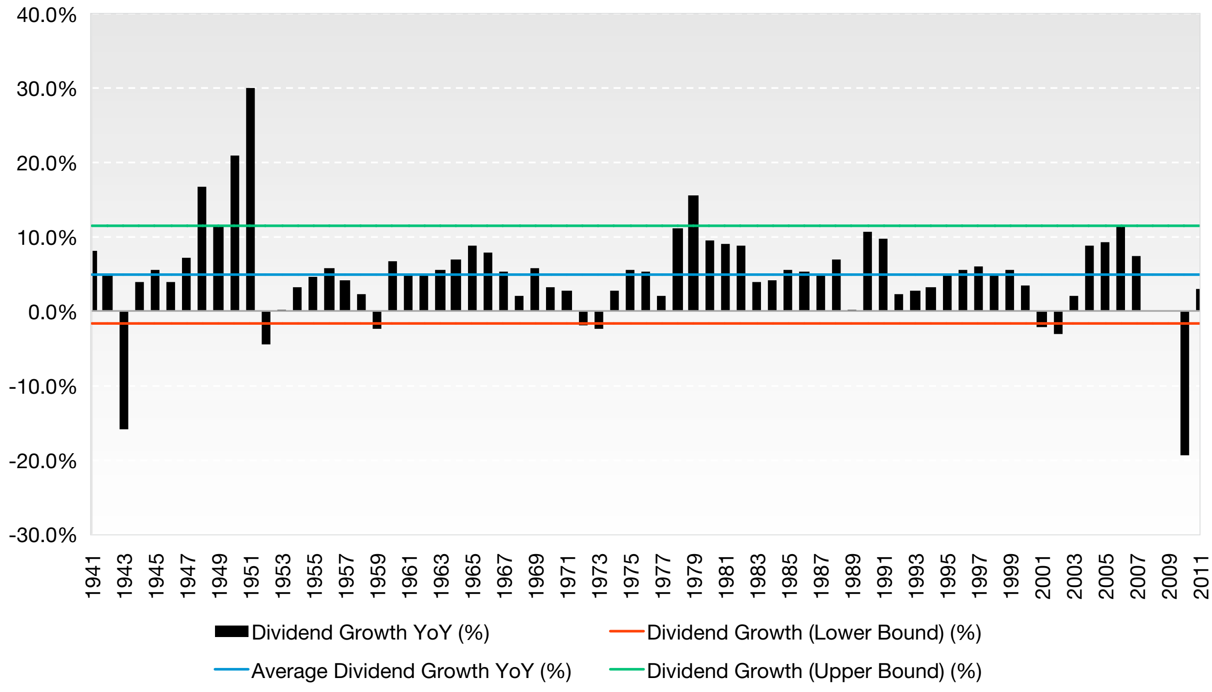
US Recessionary Period	Dividend Per Share (trough date)	Earnings Per Share (trough date)	Peak to trough (%) Dividend Per Share	Peak to trough (%) Earnings Per Share
November 1973 to February 1975	Dec-75	Sep-75	-1.0%	-15.0%
July 1981 to October 1982	n/a	Mar-83	-	-19.0%
July 1990 to February 1991	Dec-91	Jun-92	-1.0%	-32.0%
March 2001 to October 2001	Jun-01	Dec-01	-6.0%	-54.0%
December 2007 to May 2009	Mar-09	Mar-09	-24.0%	-92.0%
Mean			**-8.0%**	**-42.4%**

Source: Irrational Exuberance - Robert J Shiller, Princeton University Press, and Guinness Asset Management

On average, whilst earnings per share dropped by 42%, dividends per share only fell by 8% across the five recessionary periods, meaning that dividends only fell by about one-fifth of the drop in earnings.

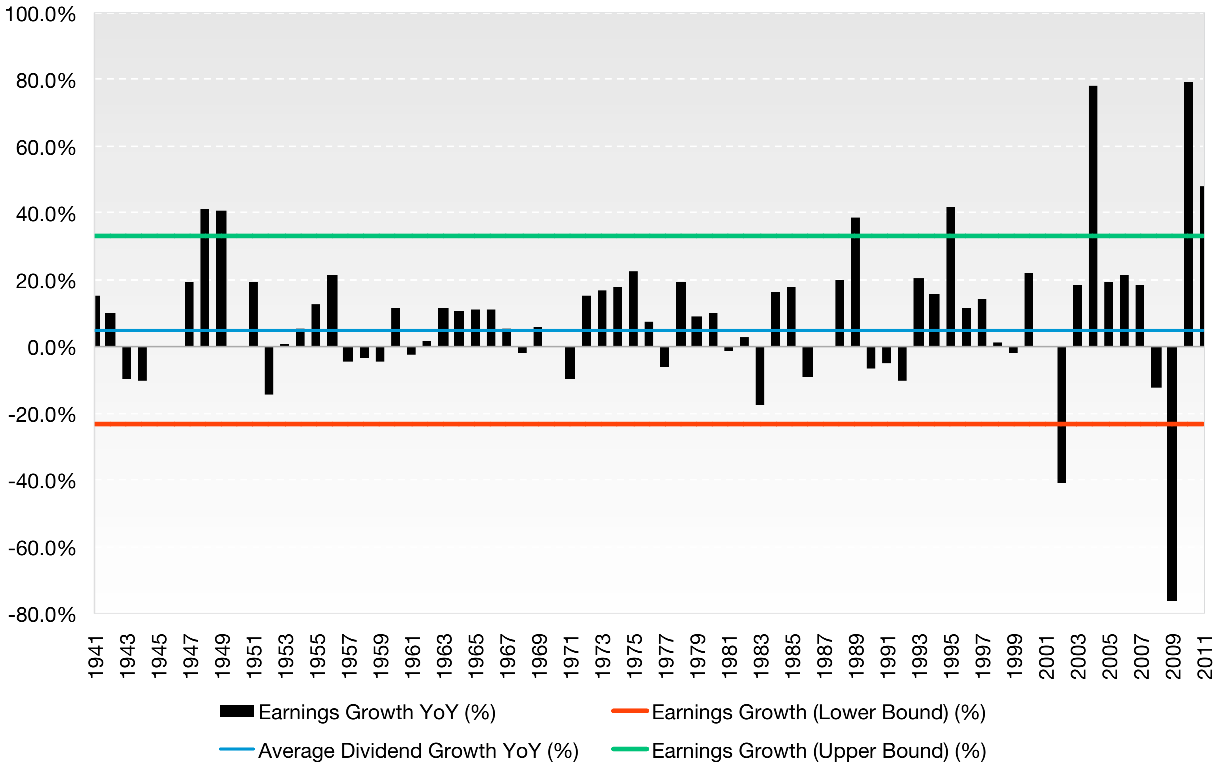
Over the period 1940 to 2011, dividends growth was very constant compared to earnings growth, with the latter falling markedly in some recessionary periods. Indeed, there were only 8 years during which dividends were cut, compared with 22 years when earnings declined. The stability of dividend payouts during those periods associated with falling stock prices has presented investors with the opportunity to smooth their downside by picking up cheaper stock with reinvested income.

S&P500 DIVIDENDS PER SHARE YEAR-ON-YEAR GROWTH COMPARISON



Since 1941, there have only been 8 years of dividend cuts, compared with 22 years when earnings have fallen.

S&P500 EARNINGS PER SHARE YEAR-ON-YEAR GROWTH COMPARISON



Sexy Earnings

Over history there has been a tendency for investors to overlook dividend-paying companies as they are seen as mature businesses with low growth potential.

They have no ‘Va Va Voom’, remember Nicole and Thierry from the Renault Clio advertisements? However, just like Nicole and Thierry we believe such companies have real sex appeal. The evidence supports this view.

Rob Arnott and Cliff Asness of CQS demonstrated there was a positive correlation between a company’s payout ratio and its subsequent earnings growth. The title of their research piece: ‘Surprise! Higher Dividends = Higher Earnings Growth’, tells you almost all you need to know. Their research ran counter to the prevailing wisdom that when payout ratios were low, earnings growth would be high. The historical perspective that management boards redeploying retained earnings into capital projects and/or empire building would accelerate future earnings growth proved not to be the case.

They concluded that high payout ratios were a good forecast of future earnings growth. Dividends paid out sensibly and consistently portend higher future total returns for the stock prices of companies pursuing such policies. Our explanation for this outcome is that investors tend to overpay for growth companies, particularly in the short term.

It is clear that downward or even sideways markets provide an accelerating return platform for an equity portfolio comprised of dividend-paying companies. The accumulation of undervalued shares by reinvestment of dividends not only underpins the ultimate downside, assuming solid long-term fundamentals, but the power of compounding such reinvestment year-on-year really makes for some sexy returns relative to benchmark indices.

Conclusion

Income levels from many traditional asset classes have fallen dramatically in the wake of the global financial crisis.

An era of low interest rates, negative real rates and low long end yields may well be set to continue if policy-makers’ forward guidance is anything to go by. If Japan is our benchmark for poor economic performance then rates in the developed world are destined to remain historically low for the coming decade. Imagine cash deposit rates at zero for the next 20 years.

Investors suffered severe losses during the financial crisis and most have not recouped these as they panicked and exited markets, or were forced to drawdown income at the worst time, but with bank deposits bearing zero income many are wondering how to deploy their savings safely in the future. Most are wary of obtaining income from less than transparent sources, but are being pressured into that nevertheless. Investments in yield enhanced strategies, via securitised products, have been shunned by those who took heavy losses in recent years, although there are those who still run the gamut of risk.

On the whole, however, there is a palpable demand amongst retail and many professional investors alike for unlevered, highly transparent, liquid investments that quite frankly they understand, as well as those that offer stable income and the chance for longer-term capital growth.

Even if rates don’t remain at zero forever, it is clear that aging developed world demographics mean there will be a constant need for more sustainable income, accompanied by a reduced exposure to potential capital losses over the next few decades. We have long understood that high relative dividend-paying stocks could provide a partial solution so we developed our own dividend-paying equity investment strategy.

Our dividend strategy differentiates itself from others as it is **an equity income strategy which captures short-term capital re-valuations combined with regularly reinvested dividend income to provide attractive real, long-term returns.**

The strategy offers an unlevered, liquid, transparent and understandable way to invest that helps investors meet the two significant criteria of income and capital growth that make up total returns. We firmly believe that investing in this approach should be an integral part of a long-term investment strategy.

Appendix I

HINDE DIVIDEND VALUE STRATEGY

An equity income strategy which captures short-term capital re-valuations combined with regularly reinvested dividend income to provide real long-term returns.

Long Only, 50% Hedge and 100% Hedge versions are available depending on investor needs.

Investment Objective *Income and Capital Growth*

The Hinde Dividend Value Strategy (50% Hedge) seeks a total return through dividend income and capital appreciation whilst maintaining partial hedges to protect capital and reduce the overall volatility of returns associated with unfavourable market conditions.

Investment Strategy *Quality over Yield & Market Protection*

The strategy pursues its investment objective by investing solely in UK large capitalised, dividend-paying common stocks, which are out of favour with their sector and the general market.

The strategy is a quantitative systematic methodology. FTSE 100 and FTSE 250 constituent stocks are screened using the Hinde Dividend Value Matrix™ (HDVM™). The portfolio is rebalanced quarterly based on the HDVM™. This is a stock-rating system used to select stocks for a portfolio of dividend-paying common stocks. This portfolio is then subject to a 50% beta* market hedge to reduce overall volatility at all times. The portfolio is hedged using the UK equity benchmark indices to reduce exposure to overall market volatility, but without reducing overall total returns to the market over the long run.

HINDE DIVIDEND VALUE MATRIX™

Dividend Rank	Performance Rank	Value Rank
Relative dividend yield	Relative stock performance	Value metrics
Dividend capture metric	Rank of relative stock performance	Quality metrics
Payout ratios		Financial stability metrics
		Volatility metrics
		Momentum metrics
		Liquidity metrics

*Beta is a stock's sensitivity to market movements. E.g. if a share has a beta of 1.5 it tends to move by 1.5% for each 1% move in the index.

Portfolio *Equally-weighted, High Quality, Dividend Payers*

The portfolio is equally-weighted across 20 highly liquid, large capitalised dividend paying companies selected from the FTSE 100 and FTSE 250 and has a 50% beta hedge against the stock portfolio.

Appendix 2

Hinde Capital - Who are we?

INVESTMENT MANAGER - HINDE CAPITAL LTD

Hinde Capital specialises in developing world-class investment solutions for institutions, family offices, trustees, as well as high net worth private clients and their advisers. Recognised as thought leaders, Hinde Capital offers investors a range of disciplined investment strategies that draw on the founders' real-world trading and risk management experience built up from previous senior roles managing money for some of the largest global financial institutions.

Investment Managers Ben Davies (CEO) and Mark Mahaffey (CFO), former colleagues from RBS Greenwich Capital, established Hinde Capital in early 2007, initially to focus on the precious metals and commodity sector. Hinde Gold Fund, BVI Ltd, was launched in October 2007. The Fund is now in its seventh year. More recently, it has introduced a range of equity strategies, which utilise the Hinde Dividend Value Matrix (HDVM)™. Hinde Capital is based in London.

Ben Davies – Co Founder and CEO
Ben Davies has over 18 years' experience within financial and commodity markets, starting his career in 1995 trading US Credit and Fixed Income before expanding his remit to take multi-asset proprietary risk at a number of leading institutions. The majority of his career prior to Hinde Capital was spent at Greenwich NatWest/RBS Greenwich Capital. In 2001 following the merger of RBS and NatWest, Ben joined Blue Sky Capital Australia, a Japan long/short equity Hedge Fund as a Portfolio Manager. The following year he was asked to return as the new Head of Fixed Income and Macro Proprietary Trading at RBS Greenwich Capital.

He left Greenwich in 2007 to co-found Hinde Capital with Mark Mahaffey and the Hinde Gold Fund was launched later that year. He is also a partner of the growing independent macro research company Variant Perception which spun out of Hinde Capital in 2008.

Mark Mahaffey – Co Founder and CFO
Mark Mahaffey has 27 years' experience in the international markets having held senior posts at several leading investment banks. He trained as a fixed income specialist at Daiwa Securities before joining Midland Montagu as Director of the US government trading desk. In 1990 he jointly set up the Greenwich Capital office in London where he managed a portfolio focusing on global macro themes, before joining IBJI in 2001. His most recent appointment from 2005 was Managing Director of Bank of America London Proprietary desk. Mark co-founded Hinde Capital in 2007. He is the co-portfolio manager of the Hinde Gold Fund and also a partner in Variant Perception.

Mark Denby – Portfolio Manager
Mark has over 17 years experience within financial markets, starting his career at Prudential-Bache Securities advising on a broad range of markets and asset classes. After spending five years at Berkeley Fund Managers, as a member of their investment committee and then director, he moved to Phillip Securities, a multi-billion dollar Asian financial house to advise private clients and run discretionary mandates. He later co-founded boutique investment manager ARIA Capital Management, launching a range of multi-strategy funds, which he co-managed whilst continuing to run private client portfolios. In 2013, Mark sold ARIA before joining Hinde Capital's growing team to develop the business alongside its co-founders.

CONTACT INFORMATION

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