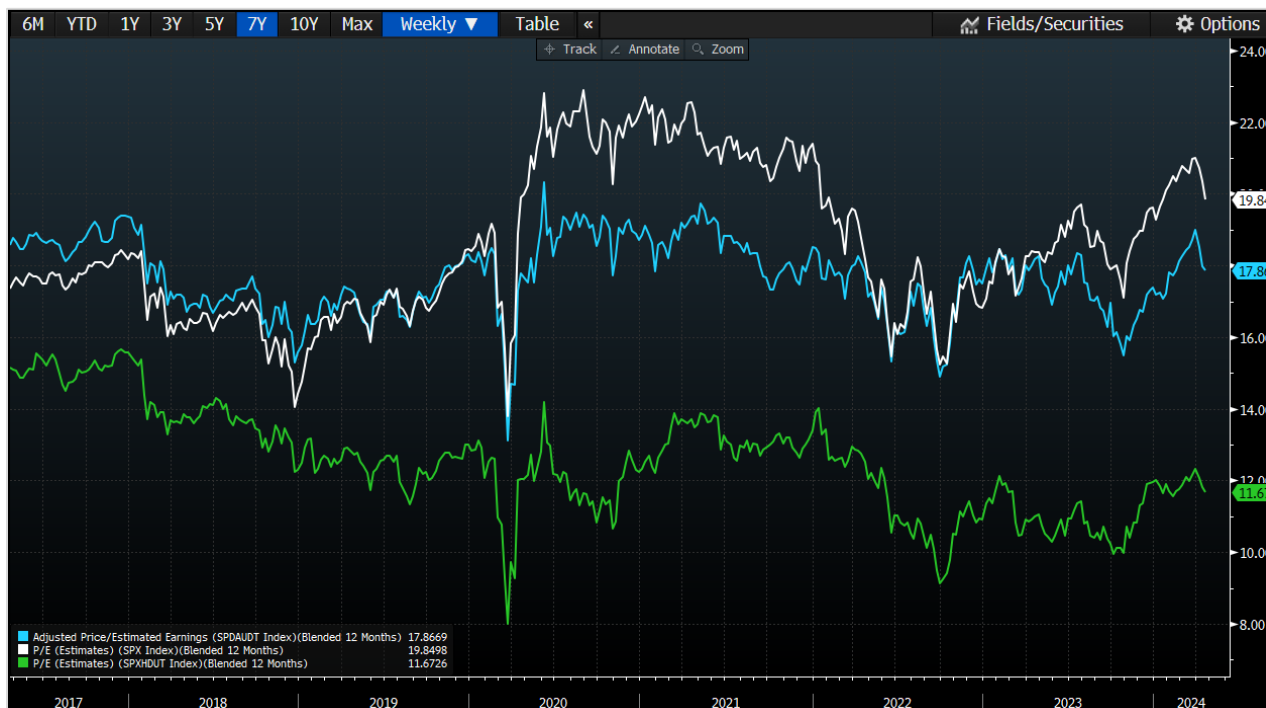


4/19/2024

One group left in the wake of this year's equity markets rally is dividend-paying stocks, largely abandoned by investors in favor of growth stocks with more positive business momentum. However, those considering increased allocations to dividend-paying stocks should be mindful to not sacrifice quality in pursuit of higher yields and lower valuations.

1. Dividend Payers, Even the High Quality Ones, Trade at a Steep Valuation Discount to the Broader Market

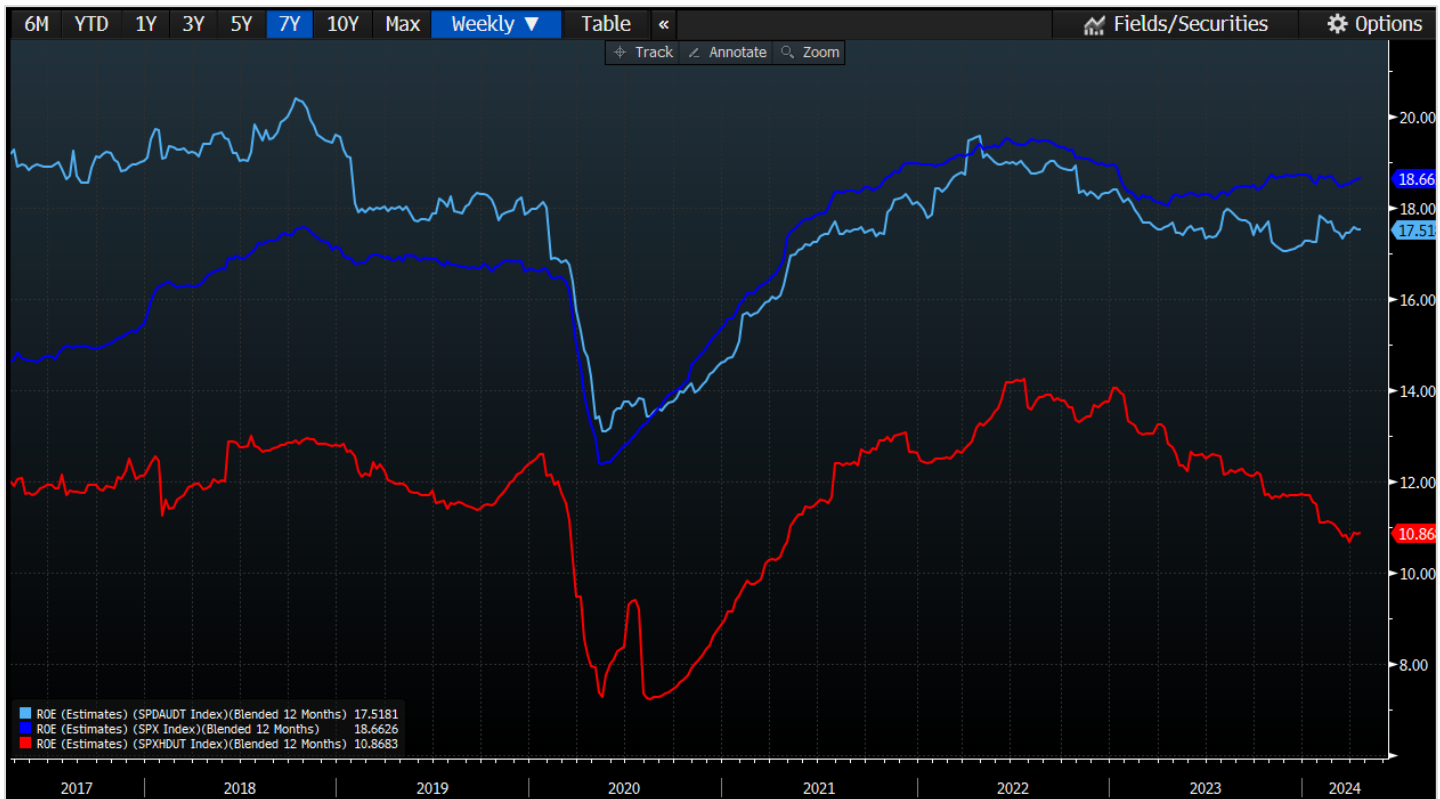
- Prior to the global pandemic shutdowns beginning in early 2020, the S&P 500 Dividend Aristocrats Index (blue line below) traded at a forward price/earnings (P/E) multiple in-line with that of the S&P 500 Index (white line).
- The S&P 500 High Dividend Yield Index (green line) has historically traded at a discount, although this valuation discount was narrower prior to the pandemic shutdown. Unlike Dividend Aristocrats, the High Dividend Yield index weights stocks based on their dividend yield. High Dividend Yield stocks tend to be treated by investors as lower quality due to high financial leverage and/or low profitability, reflecting greater uncertainty over the sustainability of current dividend payouts.
- Except for a brief period during the 2022 bear market sell-off, the valuation discounts of both dividend indices have widened throughout the post-pandemic period, a reflection of how out-of-favor dividend-focused investing has become.



Source: Bloomberg (data through 4/18/2024)

2. Dividend Paying Stocks Are Less Profitable, But One Need Not Necessarily Sacrifice Quality for Dividend Streams

- Prior to the pandemic shutdown, the S&P Dividend Aristocrats Index (light blue line) boasted a higher forward return on equity (ROE) versus the S&P 500 (dark blue line), but this has flipped following the pandemic as technology-focused stocks with strong balance sheets and higher profitability comprise a much greater weight in the overall S&P 500.
- The S&P High Dividend Yield Index (red line) has witnessed a deterioration in the projected ROE since 2022. These class of stocks have suffered disproportionately from higher interest rates, putting greater financial stress on levered balance sheets and businesses with thinner profit margins.
- S&P Dividend Aristocrats are seen as top-tier dividend payers because they have a long track record of increasing dividends, which reflects management's confidence in their companies' long-term growth. Although the ROE has not kept up with that of the broader market, the profitability gap appears to have stabilized and could be ripe for some mean reversion.



Source: Bloomberg (data through 4/18/2024)

3. Ways to Invest in High Quality Dividends on the Freedom Advisor Platform

As U.S. equity market valuations appear to be reaching resistance levels, dividends may comprise a greater share of future total returns. Investors may consider ways to diversify their broad market equity exposure with an allocation towards dividend-paying stocks, particularly higher quality ones as measured by competitive profitability, balance sheet strength, and earnings growth. Freedom Advisors offers several solutions on its platform that invest in high quality dividend stocks.

- Consider managed model offerings (SMAs and ETFs), such as 3D Dividend-Focused Large Cap, Advisor Partners US Large Cap High Quality Dividend Yield, Alpha Quant Dividend Equity, and Dearborn Partners Core Rising Dividend.

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