OVERBERG MARKET REPORT

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Global Report

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Dividend yields generate outperformance especially in troubled times

Numerous studies have shown that shares which pay high dividends beat the market. Jeremy Siegel, author of the best-selling investment analysis book, "Stocks for the long run" (published 2014), has proved it empirically with a study of the S&P 500 index. On December of each year from 1957 to 2012, he sorted the firms in the S&P 500 index into five groups (quintiles) ranked from the highest to the lowest dividend yields and then calculated the total returns over the next calendar year. The results are striking. A $1000 invested in an S&P 500 index fund in 1957 would have accumulated $201,760 by the end of 2012, for an annual return of 10.13%. An identical investment in the 100 highest dividend yielders accumulated to $678,000, with an annual return of 12.58%. The lowest dividend yielders not only had lower returns they also suffered greater volatility. If the market has a beta of one, high yielders enjoyed a beta of less than one and low yielders a beta of more than one.

Return on S&P 500 Stocks Ranked by Dividend Yield, 1957-2012

Dividend Yield	Geometric Return	Standard Deviation	Beta
Highest	12.58%	19.34%	0.94
High	12.25%	16.26%	0.82
Mid	9.46%	16.64%	0.92
Low	8.79%	19.29%	1.07
Lowest	8.90%	23.82%	1.23
S&P 500	10.13%	17.15%	1.00

The strategy is especially relevant in today's market environment of global supply shocks in food and energy, excessive inflation, surging interest rates and bond yields and the increasing risk of recession. In an MRB Partners report titled "Dividends pay dividends in tough times" (July 26 2022), Peter Perkins writes that "Dividends are more stable than earnings and provide a buffer for equities during periods of weakening global economic growth…Like earnings, dividend payments are sensitive to the economic cycle, but less so, with companies typically reluctant to cut dividends in anything but exceptional circumstances." The dividend amount paid to shareholders in relation to the total amount of net income a company generates is known as the dividend payout ratio. This ratio is typically well below one which means companies have capacity to maintain a stable dividend even when earnings decline by lifting the dividend payout ratio.

According to MRB Partners, reinvested dividends have accounted for approximately 40% of aggregate total return for global equities since 2000. Global high yielding stocks outperformed during the past three US recessions. As expected, performance has also been more stable. While for most of the past three decades dividends and earnings have grown at a similar pace, the variation in annual dividend growth has been less than half that of earnings. Currently, "the global dividend payout ratio is toward the lower end of its historical range and has ample room to rise as economic growth weakens."

The MRB report concludes, "beyond the near term, dividends are likely to play a more important role in equity returns than has been the case in recent decades. In fact, we expect dividends to account for the majority of equity total returns in the next decade for most markets and the global benchmark as the tailwinds of three decades of strong real earnings growth and rising P/E ratios fade."

OAM's global portfolios contain numerous high yielding shares, which help to drive and stabilise performance. The list below summarises the company name, dividend yield and growth in net asset value over the past five years. These companies are all listed on the London Stock Exchange and due to weak market sentiment, all currently trade at substantial discounts to net asset value, providing an added margin of safety. Their high dividend yields combined with their cheap valuations (NAV discounts) place the portfolios in a strong position to continue generating healthy and stable returns, even in troubled times.

OAM high dividend yielding shares

Share	Company mandate	Dividend yield	Discount to NAV	NAV Total Return over 5 years
Murray International	Global growth & income	4.40%	-2.90%	31.40%
Edinburgh Investment	UK growth & income	4.10%	-7.40%	5.00%
Murray Income trust	UK growth & income	4.60%	-7.10%	18.70%
VinaCapital Vietnam	Vietnam multi asset class	3.20%	-21.80%	60.10%
International Biotechnology	Biotechnology (mainly US)	4.70%	-6.30%	36.80%
3i Infrastructure	Europe infrastructure	3.30%	-2.50%	86.90%
Greencoat UK Wind	Renewable energy	5.20%	-5.20%	89.60%
Hipgnosis Songs	Music royalties	6.20%	-47.30%	64.10%*
BioPharma Credit	Specialist credit (mainly US)	12.00%	-4.00%	84.90%

* NAV total return after 3 years as company was listed in 2018.
NAV: Net Asset Value

To increase your dividend exposure for your own portfolio, reach out today. Our Wealth Managers can guide you.

Local Report

Werner Erasmus

Four ways to beat inflation

Inflation is a big destroyer. In recent months we have seen, on a global scale, how destructive inflation is. It raises prices, destroys the purchasing power of money, destroys savings and wealth, and lowers living standards. Hyperinflation (unmanageable increases in prices) has destroyed several countries – Zimbabwe and Venezuela are two recent examples. Venezuela had an inflation rate of 65,000%. In Zimbabwe, prices doubled every day. To make things worse, we pay an indirect tax on inflation. Taxable profits always include the full inflation rate – there is no tax allowance for inflation. A profit of ten million dollars includes the inflation rate (of say 10%), or one million dollars, which will be taxed in South Africa at 27%, or $270,000.00. Academics call it an inflation tax. Nobel prize laureate in Economic Sciences, Milton Friedman once remarked: “Inflation is taxation without legislation.” Elon Musk was more outspoken: “Inflation is the most regressive tax of all, yet it is advocated by those who proclaim to be progressive.”

Investors need to monitor the inflation rate. Why? Stocks do not perform uniformly during times of rising inflation – performance differs widely. Investors can monitor a stock’s performance by looking at the trend of the stock’s historical data. Investors should make sure that some assets in their portfolios are more resilient to the impact of inflation. The risk is that the higher the inflation rate, the lower the real return on your assets. To determine the real rate of return for companies, you need to take the annual return earned and subtract the inflation rate. There are four strategies to consider when investing during inflationary times.

Number 1: Invest in companies with low debt: Gielie Fourie, research analyst at Overberg Asset Management advises investors to avoid companies with too much debt on their balance sheets. This would make sense especially when you consider that when inflation picks up, interest rates usually rise – this is how the Federal Reserve manages inflation. This means that there will be higher interest costs for companies if they have a lot of debt on their balance sheet. Higher finance cost results in lower earnings and a resulting decline in share price.

Number 2: Invest in companies that can pass on the inflation burden to consumers. During 2022’s rapid increase in inflation, many companies have reported lower profits, due to rising operating costs. However, some products have price elasticity, meaning that despite rising prices, consumers will not buy less units of the product. Medicine is a case in point – even if the price rises, you must still have your medicine. These companies are often monopolies or oligopolies in their industries. Companies with a clear competitive advantage could fall into this category as well. By investing in companies that can keep their profit margins despite rising costs, your portfolio could be more resilient during times of inflation. Defensive sectors such as utilities, consumer staples, healthcare and telecommunications can pass on costs to consumers and tend to perform better during times of high inflation.

Number 3: Invest in commodities: You can invest in physical commodities or in companies involved in the commodities industries. Commodities would include metals (gold, silver, platinum, copper), energy (oil and coal producers like Sasol and Thungela), livestock, and agriculture. To learn more about energy as a commodity investment, you can read our South African Report on investing during inflation of 28 June 2022. When investing in commodity companies, it is best practice to consider the financial health of the company in which you are investing. This is a rule for each purchase and each scenario, not just commodities.

Number 4: Invest in inflation-protected securities: Inflation protected securities such as TIPS (Treasury Inflation Protected Securities). TIPS are government bonds that mirror the rise and fall of inflation. So, when inflation goes up, the interest rate paid also goes up. And when deflation occurs, interest rates fall. Because TIPS are backed by the U.S. federal government, they are one of the safest investments and an effective way to diversify your investments while also supplementing future retirement income. Locally an inflation linked bond ETF that tracks the performance of the S&P South Africa Sovereign Inflation-linked Bond 1+ Year Index can be used. The bond's principal in the fund is indexed to the local inflation rate. As such, the security typically guarantees a return above inflation if held to maturity.

BOTTOM LINE: The American-born British investor Sir John Templeton once said: “For all long-term investors, there is only one objective - maximum total real return after taxes.” Experienced investors examine the landscape and act accordingly. During times of high inflation, it is important to trade less than normal. “Inflation tax has a far more devastating effect on after-tax real returns when the holding period is short than when it is long. The more frequently an investor buys and sells assets, the more frequently the government can tax the nominal capital gain, which might not be a real, after-inflation gain, at all.” Prof. Jeremy Seigel. The strategies outlined above can be used as a roadmap. This does not serve as financial advice as many factors would need to be considered for each individual investor. If you need advice, contact one of our experienced consultants for a gratis – no inflation added – consultation.