ARTICLE
For professional investors
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High dividend investing: buy them stable & strong

- Dividends are a significant and stable component of equity returns
- Dividends help to reduce risk and enhance long-term returns
- Income oriented investors should opt for the best of three worlds: low risk, strong return and high dividend

Pim van Vliet,
Maarten Polfliet
Jan-Sytze Mosselaar

Investors often focus on short-term price fluctuations. However, dividends account for a stable and significant part of the equity premium, over the long-term. This is also true for Robeco Conservative Equities. Since inception in 2006, our defensive strategy delivered 8% return per year, of which 4% came from dividends. Conservative Equities offers the best of three worlds compared to a market cap-weighted index: a higher dividend, in line with the MSCI High Dividend Yield index; a lower risk, in line with the MSCI Minimum Volatility index; and a higher return, similar to the MSCI Momentum index.

'Dividends are a silent ingredient of equity returns'

Daily noise versus long-term information

Many investors tend to pay too much attention to daily news, while often underreacting to long term trends. For example, daily stock price moves are often larger than the total dividend earned over a full year. In any given year, equity returns are mostly driven by changes in growth expectations and changes in the discount rate. The bigger picture only emerges when a truly long term perspective is taken. Over the past century, about half of

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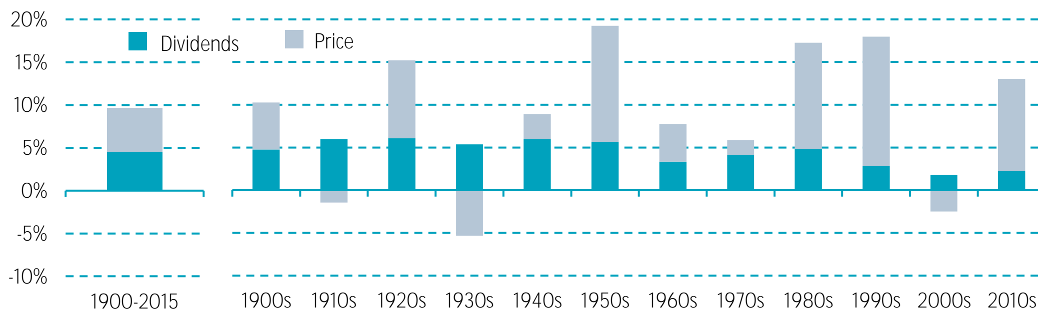
the equity return came from dividends and the other half from price changes. Figure 1 shows the US equity return decomposition with evidence going back to 1900. Over this very long period, equities delivered a total return of 9.5% of which 4.5% came from dividends and 5.0% from price increases.

Figure 1 | Equity return decomposition of US stocks since 1900



Source: Shiller and Robeco

The figure also shows results for each decade taken separately. For example, during the 1990s, US equity returns delivered 18% return of which 3% came from dividends and 15% came from price appreciation. By contrast, during the 2000s, stock prices fell by about 3% per year, while the dividend component was quite similar to the previous decade. Interestingly, dividends delivered a stable positive contribution to return in each decade. Dividends prevented equity returns to be negative during the 1910s and 1930s. In fact, chances of losing money with stocks are significantly reduced when dividends are taken into account. More specifically, in any given ten-year period the chance of losing money is reduced from 17% to 4%, due to the positive contribution of dividends. Obviously, reducing price volatility is an effective way to reduce chances of losing money, but dividends can also play an indirect, often overlooked, role in reducing stock market risk.

Dividends and buybacks

For most of the 20th century companies were generally not allowed to buy back shares. Since the 1980s buybacks started to become more common, which is possibly related to a change in SEC rules which passed in 1982. In 2006, the amount of US buybacks exceeded the amount of US dividends for the first time.

Why dividend is an important factor

Over the past century, the average dividend yield of all US stocks was about 4.5% per year. Still, not all stocks distribute dividends back to shareholders. High-dividend stocks have different characteristics compared to low-dividend stocks. Usually, they tend to be more mature firms, with conservative management. Academic, price-based factors are referred to as a 'value' investment style. Using data from Kenneth French, we will compare dividend/price to book/price, earnings/price and cashflow/price factors. The sample period stretches almost 70 years back in time to 1951. Figure 2 shows the volatility of the four price-based factors (left-hand graph) and the risk-return profile of four dividend-sorted portfolios

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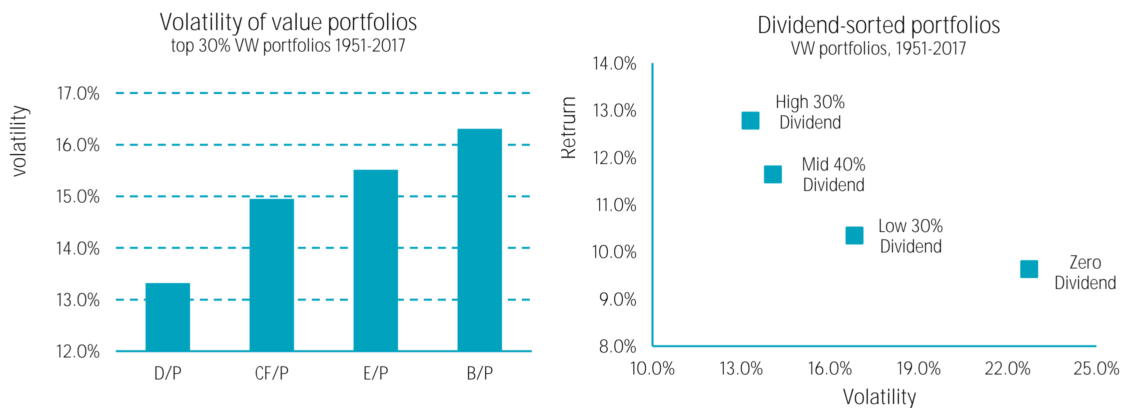
(right-hand graph). The left picture shows that dividend is the most defensive **'value'** investment style and that book-to-price (B/P) is the riskiest one. The risk is about 20% lower for high-dividend (3 percentage points in absolute volatility). In addition to a lower volatility, high-dividend stocks also generate high returns. Over this sample period, high dividend stocks (High 30% Dividend) earn 4% higher returns compared to stocks which do not pay dividend (Zero Dividend). Therefore, of these four value measures, dividend yield has the best fit with a low-volatility strategy, as it is a much more defensive type of value strategy.

Figure 2 | Dividend portfolio offers lower risk and attractive returns



Source: Kenneth French data library

Systematically investing in stocks which pay a high dividend is an effective way to reduce volatility, while at the same time enhancing returns. This superior risk-return profile is one of the reasons why high-dividend investing is such a popular investment style.

Conservative Equities and dividends

Conservative Equities is a defensive strategy which aims to maximize the return per unit of absolute risk. The first goal is to reduce risk by using a combination of statistical low-risk factors and proprietary, more forward-looking distress risk factors. Secondly, the aim is to enhance returns by adding customized valuation/income and momentum/sentiment factors to the model. As shown in figure 2, high dividend is an attractive factor because it offers both a lower risk and a higher return. Therefore, Robeco Conservative Equities selects firms with high and stable dividends. In addition, we also take into account share buybacks, as some companies prefer to buy shares back rather than pay dividends. The combination of dividends and share buybacks is often referred to as total shareholder yield (also see Boudoukh et al, 2007). Moreover, if the price momentum of a stock is strong, earnings revisions are positive and there is a strong credit momentum, the risk of lowering

> 'We buy them stable and we buy them strong'

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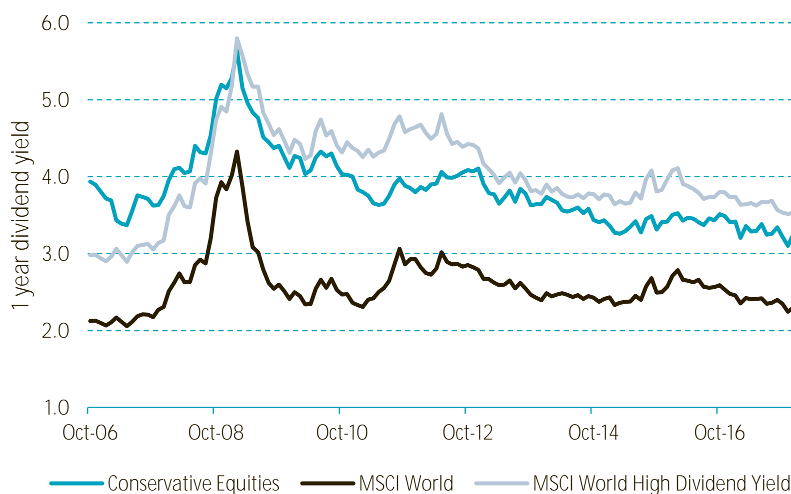
dividends is mitigated. Momentum also helps to avoid value traps and to reduce risk. Therefore, we want to buy stocks **'stable' and we buy them 'strong'.**

As shown in figure 3, the average dividend yield of Conservative Equities was between three and 6% over the live period, which started in October 2006. This dividend yield has always been higher than the average dividend of the MSCI World index, which remained between two and 4%. The dividend yield of Conservative Equities was close to the dividend yield of the MSCI High Dividend index, with an average dividend yield of 3.8% against 4.0% for the index. During the 2008 financial crisis, many high-dividend stocks turned out to be quite risky (e.g. financials). The fact that risk is more important than dividend in our strategy explains why Conservative Equities has given up some yield compared to the High Dividend index since 2009.

Figure 3 | Dividend yield Global Conservative Equities since 2006



Source: MSCI and Robeco

> **Shareholder yield**
> Dividends and stock repurchases together are referred to as total shareholder yield. It is a price-based variable and can therefore be classified as a 'value' factor. In addition, it can be linked to profitability and quality. Profits can be distributed to shareholders and a high pay-out ratio helps managers to control their overconfidence and not waste shareholder money on bad investment projects.

Return decomposition

In figure 1, we decomposed the US equity market premium going back to 1900. We will now move from deep historical US data to a more recent sample period, using global data. The sample period ranges from October 2006, the starting date of Robeco Global Conservative Equities, until December 2017. Over this period, the MSCI World index delivered a total return of 5.6%. Of this total return 2.1% came from dividends and 3.5% from price returns. Figure 4 shows the cumulative return of the price and dividend components over time. The global financial crisis of 2008 is clearly visible, as well as the steady component of dividends, which helped to reduce drawdowns. A dollar invested in the global stock market in October 2006, would have been worth 57 cents in February 2009, a 42.8% collapse (black line figure

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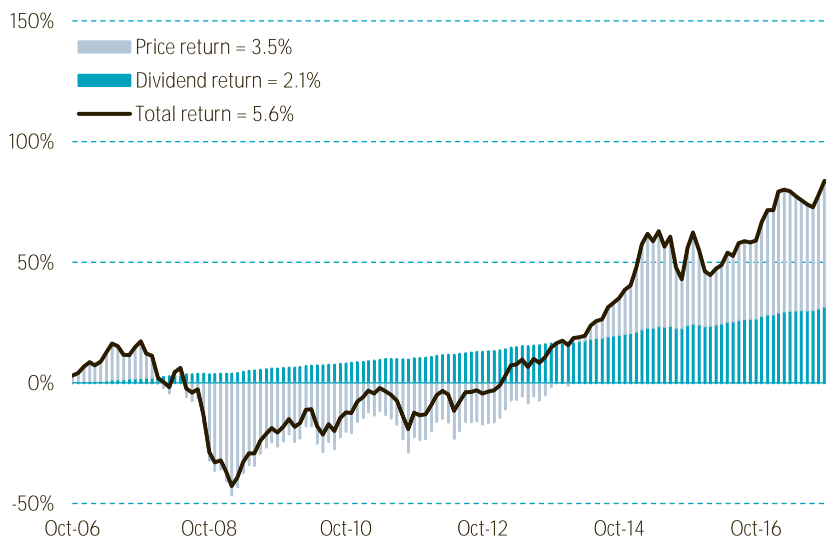
4). Cumulative dividends during this period amounted to 4.7%, which helped to reduce drawdowns and limit losses (we use the methodology of Cariño, 1999). From this market low, it took exactly four years to break even, a point reached in February 2013. Dividends proved helpful again. Without compounded dividends, investors would have had to be very patient and stay invested for another 12 months to break even. Interestingly, the price return is determined by a few strong (>15%) years, such as 2009, 2013 and 2014. Meanwhile, dividends steadily contribute to returns in each and every single year.

Figure 4 | MSCI World cumulative return decomposed



Source: MSCI and Robeco

> 'Dividends steadily contribute to long-term returns'

Figure 5 shows the same price/dividend return decomposition, but now for the Robeco Global Conservative Equities strategy. Conservative Equities delivered a total return of 8.0% over this period. Of this total return, 3.9% came from dividends and 4.1% from price returns. Compared to the MSCI World index, the return from dividends of Conservative Equities was 1.8 percentage point higher (3.9% vs 2.1%). Interestingly, this higher dividend almost fully explains the excess return of 2.4%. Dividends also indirectly help to reduce drawdowns. The decline of Conservative Equities was 29.7%, significantly lower than the 42.8% fall of the MSCI World index. From October 2006 until the market low in February 2009, cumulative dividends were 8.4% for Conservative Equities, versus 4.7% for the MSCI World index. In this analysis, the breakeven date for Conservative Equities was October 2010, or 29 months earlier than the breakeven date for the MSCI World index. This was possible thanks to a lower price return volatility and a higher dividend yield. We can conclude that lowering price volatility helps to reduce drawdowns, but dividends also play an important role. This 'cushion' is usually not directly visible, but with this split it becomes more obvious.

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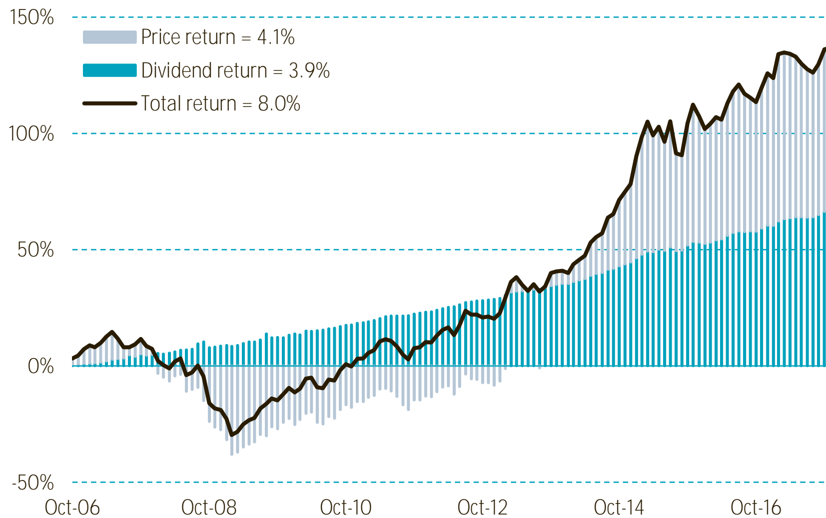
Figure 5 | Global Conservative Equities return decomposed



Source: MSCI and Robeco. Dividend returns are based on received dividends from the underlying stock portfolio in the Dutch fund Robeco Institutional Conservative Equities Fund and is hence based on Dutch tax treatment. Other tax regimes may lead to different results.

Usually, net index returns are used to make up for the impact of withholding taxes on dividends. In figures 4 and 5, we decompose total net returns into a price return and dividend return component. This means dividend yields are shown after taxes. This difference amounts to about 50bps for the MSCI World index, but varies depending on the home country and tax treaties with foreign countries. For strategies with a higher yield, this difference matters even more. For the MSCI World High Dividend Yield index, for example, the gross dividend return was 4.4%, while the net dividend return contribution was 3.5%.

Dividends and drawdowns

Dividends can help to reduce drawdowns. If price volatility is the same for two stocks, the difference in compounded dividends will act as a 'margin of safety' and reduce drawdowns.

Best of three worlds

Conservative Equities is an active low-volatility strategy, with a primary focus on risk reduction. The volatility reduction compared to the MSCI World index has been 27% since inception in October 2006 (10.4% versus 14.3%). In addition to comparing the strategy with the MSCI World index, it also makes sense to compare it with a low-volatility index. In this case, we use the MSCI World Minimum Volatility index. This index achieved a similar volatility reduction, but can go against other proven factors. For example, dividends and momentum are not explicitly taken into account in the index construction. Since low-volatility stocks tend to distribute above average dividend, a significant part of the return still comes from dividends. The dividend yield of the MSCI World Minimum Volatility is

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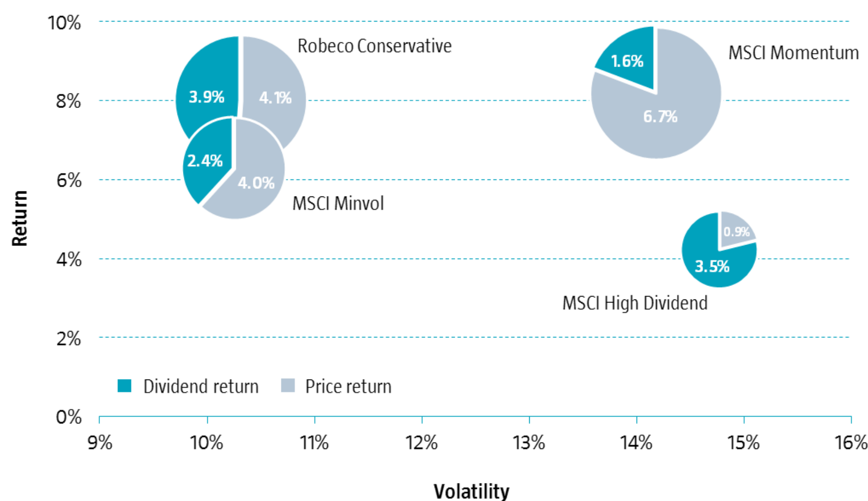
slightly higher compared to the MSCI World (+0.3 percentage point) but is lower compared to Conservative Equities (-1.5 percentage point).

Robeco Conservative Equities explicitly includes dividend and momentum factors in the stock selection process as well. It is therefore interesting to compare Robeco with three MSCI factor indices: the MSCI Minimum Volatility index (risk-focus), the MSCI High Dividend Yield index (yield focus) and the MSCI Momentum index (return focus).[1] Figure 6 below shows (1) the return decomposed in price and dividend, as well as (2) the volatility for Robeco Conservative Equities and the three MSCI indices.

Figure 6 | Robeco versus MSCI Factor indices, live period 2006-2017



Source: MSCI and Robeco[2]

Over this full sample period, **Robeco was able to provide 'best of three worlds'**. The risk reduction was similar to the Minimum Volatility index. The dividend yield was in line with the High Dividend Yield index, while the total return was similarly strong compared to the

Best of three worlds?
A concentrated portfolio with deep and efficient factor tilts can have exposure to multiple factors, adding up to >100% total factor exposure. Especially, when factor indices are not concentrated and/or have negative exposure to each other. We have proven that this is possible.

[1] The MSCI World High Dividend Yield Index was launched in October 2006, the MSCI World Minimum Volatility index was launched in April 2008, and the MSCI World Momentum Index was launched in December 2013. Before these dates, MSCI provides backfilled data which are based on back tests and not on real-life performances. All index returns are net of taxes and gross of transaction costs. MSCI Minimum Volatility base currency for optimization is EUR.

[2] Source: Robeco Performance Measurement. Monthly data since inception October-06, gross of fees, based on net asset value of Robeco Institutional Conservative Equity Fund. The fund and reference indices are unhedged for currency risk as of June 30 2012. Index returns are based on net returns, as a result dividend return of MSCI High Dividend Yield is relatively low due to the impact of withholding taxes which substantially lower the amount of dividend reinvested. In reality costs (such as management fees and other costs) are charged. These have a negative impact on the returns shown. Results obtained in the past are no guarantee for the future. The value of your investments may fluctuate.

Momentum index. Interestingly, the return decomposition was quite different for all three MSCI factor indices. For example, the largest proportion of return of the MSCI Momentum index came from price changes rather than dividends, while for the MSCI High Dividend index it was the opposite. The MSCI High Dividend index had a net dividend return of 3.5% and a gross dividend return of 4.4%, which we will round to 4.0% for the average investor. A popular belief is that momentum stocks are more risky than high-dividend stocks. However, figure 6 shows that this has not been the case in recent years. Over the real-life 2006-2017 period, the MSCI High Dividend index had relatively low returns with high risk. This style showed weak relative performance over the past years and including dividend in our model did not help our performance either. However, we still believe that the yield factor offers alpha going forward, given the strong long term evidence that supports it. To harvest long term factor premiums, one should either be very patient, or combine and integrate different factors to limit the 'pain' and to keep strong hands (see our white paper on strong hands). Therefore, we combine and integrate different factors to get best of both worlds. We even go one step further. We aim to offer our conservative clients the best of three worlds. These are our results so far summarized in three statistics:

- 96% of the risk reduction of the Minimum Volatility index (27% versus 28%)
- 98% of the dividend return of the High Dividend Yield index (3.9% versus 4.0%)
- 96% of the total return of the Momentum index (8.0% versus 8.3%)

'High-dividend stocks tend to have lower risk'

Examples of high-dividend stocks with high/low risk

We have discussed volatility and dividend on an index and portfolio level. It is interesting to dig a little deeper and provide some concrete company cases. To illustrate this, we use data for 4,800 global stocks at the end of 2017. On average, stocks with a higher dividend tend to have lower volatility. Figure 7 shows a non-linear and negative relationship between the three year volatility and the dividend yield. The R-squared is 6.4%, which means that high-dividend stocks tend to have lower volatility, on average. Still, it is not a perfect fit. Therefore it is possible to find many high-dividend stocks with a high volatility, and vice versa.

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Figure 7 | Dividend yield and 3-year volatility of 4,800 stocks

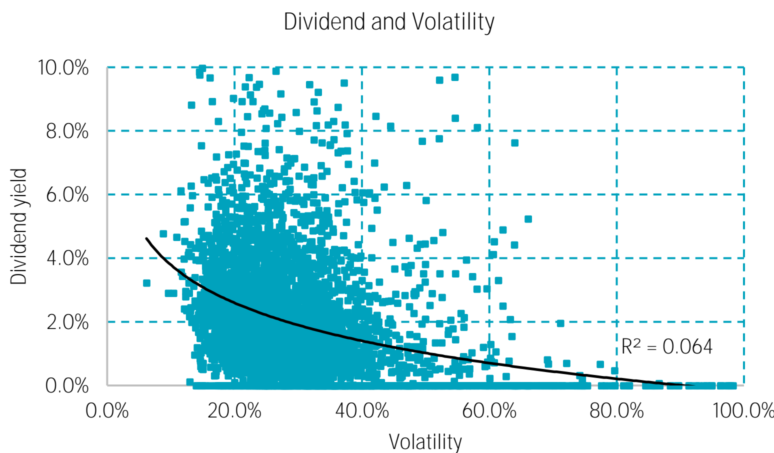

Figure 8 below shows 20 large stocks with dividend yields above 4.5%. These stocks are split in two groups based on risk. The first group consists of ten low-risk stocks, while the second group consists of ten high-risk stocks. We measure risk on two dimensions: historical three year volatility and credit-default-spreads.

These are just 20 examples for illustrative purposes, from our global investment universe of 4,800 stocks. The two tables show that low risk and high dividend are clearly two different phenomena. While both groups of stocks have a high dividend, the first group has a lower risk compared to the second group. For example, the average CDS spread is 50bps lower (1.6 compared to 2.1 percentage points) and the average volatility varies by a factor of almost two (18.1% against 34.2%). Since risk is not rewarded, we are selective and focus on low-risk stocks, that also exhibit a high and stable dividend. We like the ten stocks in the upper half of the table and avoid the ten stocks in the lower half of the table. We like to include high-dividend stocks, but aim to avoid unnecessary risk. Finally, the table shows that low-risk and high-dividend stocks can be found in different sectors and countries. Consequently, it is also possible to avoid a sizable overall sector and/or country bias in the portfolio.

‘Not all high-dividend stocks have equal risk’

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Figure 8 | 20 high-dividend stock examples

High-dividend (>4.5%) - Low Risk			Volatility	CDS	DY
Malayan Banking	MY	Financials	13.4	1.9	6.0
Southern Co/The	US	Utilities	14.4	1.8	4.5
Singapore Telecommunications	SG	Telecom	15.9	1.6	4.7
Telstra Corp	AU	Telecom	16.5	1.5	8.9
National Grid	GB	Utilities	16.9	1.7	5.1
Muenchener Re	DE	Financials	18.5	1.4	4.6
CTBC Financial Holding Co	TW	Financials	19.7	1.6	4.9
Svenska Cellulosa	SE	Materials	21.4	1.8	7.5
Occidental Petroleum Corp	US	Energy	21.7	1.6	4.5
TOTAL	FR	Energy	22.9	1.4	5.2
Average			18.1	1.6	5.6

High-dividend (>4.5%) - High Risk			Volatility	CDS	DY
L Brands	US	Cons. Discretionary	29.2	2.3	4.9
Casino Guichard Perrachon	FR	Cons. Staples	31.4	2.2	6.5
Intesa Sanpaolo	IT	Financials	32.0	1.8	6.3
Pitney Bowes Inc	US	Industrials	33.7	2.6	7.6
Société Generale	FR	Financials	33.8	1.4	5.1
Rio Tinto	GB	Materials	34.1	1.8	5.0
Aegon	NL	Financials	34.8	1.8	5.1
Macy's	US	Cons. Discretionary	36.3	2.5	7.3
Teva Pharmaceutical Industries	IL	Health Care	37.4	2.5	8.2
Navient Corp	US	Financials	37.5	2.5	5.1
Average			34.2	2.1	5.9

Concluding remarks

Investors often focus on short-term price fluctuations. Over the long-term dividends are a stable and significant part of the equity premium and should not be neglected. This is also true for our Conservative Equities strategy. Since inception in 2006 our defensive strategy delivered 8 percent return per year, of which 4 percent came from dividends. Conservative Equities offers the best of three worlds: a higher dividend in line with the MSCI High Dividend Yield index, a lower risk in line with the MSCI Minimum Volatility index, and a higher return in line with the MSCI Momentum index.

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Boudoukh, J., Michaely, R., Richardson, M., and Roberts, M. R. (2007). "On the importance of measuring payout yield: Implications for empirical asset pricing." The Journal of Finance, 62(2), 877-915.

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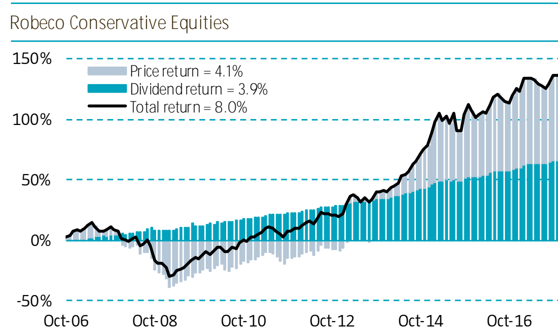
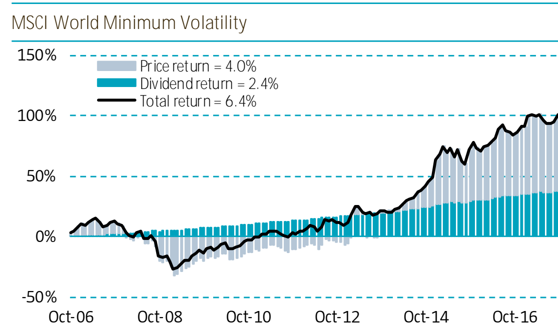
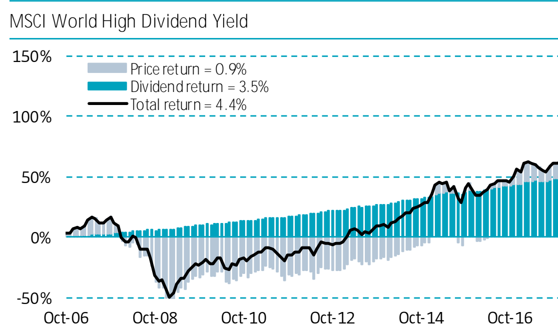
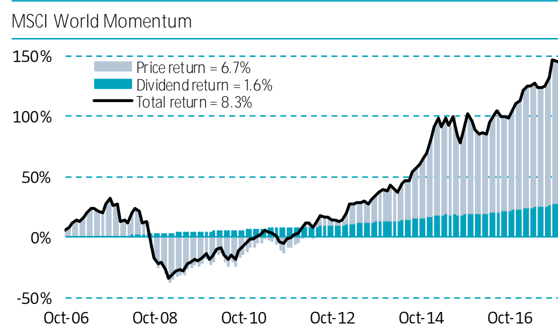
Appendix: Return decomposition Conservative Equities and Factor indices









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The sale of the Fund qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627. The Fund must not be offered or sold to the public in Uruguay, except in circumstances which do not constitute a public offering or distribution under Uruguayan laws and regulations. The Fund is not and will not be registered with the Financial Services Superintendency of the Central Bank of Uruguay. The Fund corresponds to investment Funds that are not investment Funds regulated by Uruguayan law 16,774 dated September 27, 1996, as amended.

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