VAN LANSCHOT KEMPEN

INVESTMENT MANAGEMENT

Market Musings 11/24

For Professional Investors only

Off the Beaten Path: Staying True to Dividend Investing

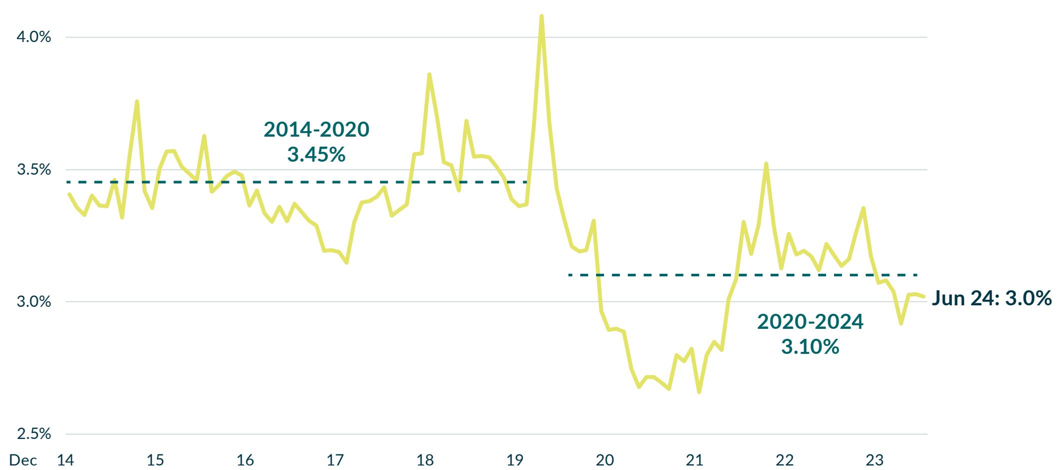
Over the past few years, we have noticed a remarkable shift: the dividend yield of global dividend strategies has been in decline. Increasing exposure to mega-caps with steep valuations has shifted the category away from high dividend yields. On average, global dividend strategies have also increasingly resembled the MSCI World in terms of style tilt, thereby reducing the diversification benefits of investing in dividend equities. By sticking to our investment philosophy, our strategy increasingly stands out within the peer group, with a portfolio consisting of out-of-the-ordinary companies.

Following the crowd

Global Dividend strategies are a well-established group. There are 50 global dividend funds with at least €100 million assets under management each, managing a total of €75 billion*. Their mandate typically requires that these funds provide an income and aim for capital growth.

In recent years however, the median yield of these funds has taken a notable step down, as shown in the graph below. This drop was for a long time attributed to falling yields across financial markets. However, this argument no longer holds as rates have increased recent years. In fact, there has been a structural shift visible in the investment style of many dividend funds that explains their lower yields. We identified two primary factors that drive this trend.

Dividend yield has declined over the last 5 years
Median dividend yield of the Global Dividend category for the period 2014–Jun 2024

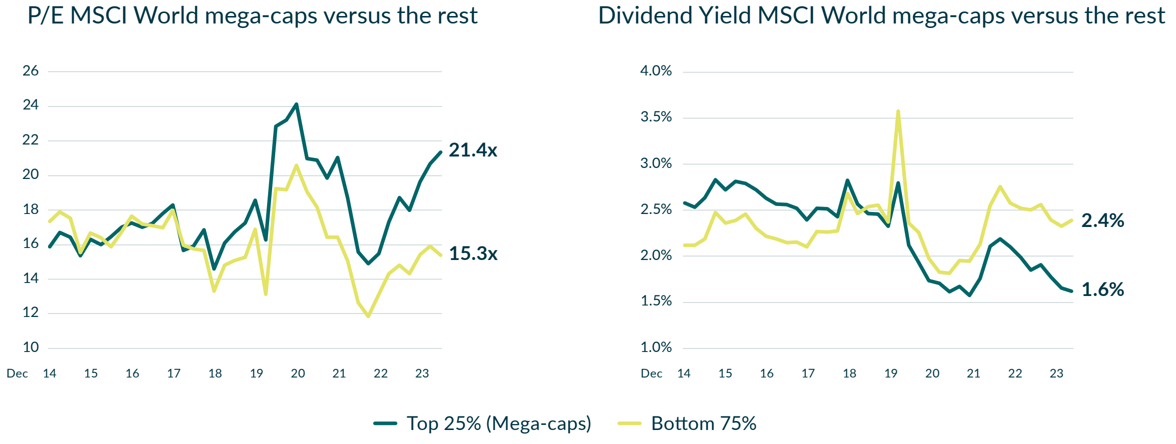


Source: Van Lanschot Kempen, Morningstar and Bloomberg. Period: Dec 2014–June 2024.

**Source: Van Lanschot Kempen, Morningstar Direct. As of end of June 2024.*

First, valuations of the largest companies have increased. As a result, yields of this cohort are lower and valuations are less attractive. Currently, mega-caps trade at a significant valuation premium to the rest of the market and offer the lowest yield. While in the past they offered a higher yield at a comparable valuation.

Dividend yield of the largest companies has declined as valuation has increased



Source: Van Lanschot Kempen, Factset Period: Dec 2014–June 2024.

Second, there has been a shift in the type of companies in which dividend funds invest. Following the strong performance of growth companies and more of those companies starting to pay a dividend, focus has shifted from investing in companies with a high current dividend yield to companies with high expected dividend growth. A clear point of evidence of this shift is that over 70% of Global Dividend funds currently have exposure to the 'Magnificent 7'. Currently, none of these mega-cap companies has a dividend yield above 1%*.

Dividend strategies have historically tilted towards larger-caps as dividend payments are a characteristic of larger, more mature companies. There used to also be a tilt towards value. Dividend is a fundamental factor, and when valuations rise the dividend yield inevitably goes down.

Over time, by sticking to large-caps, the investment style of dividend funds has moved away from value-investing towards a more blended portfolio. The chart below shows the style drift of the dividend category over time, as published by Morningstar. With that, the exposure offered by global dividend funds looks more like that of the MSCI World and thus offers less diversification benefits.

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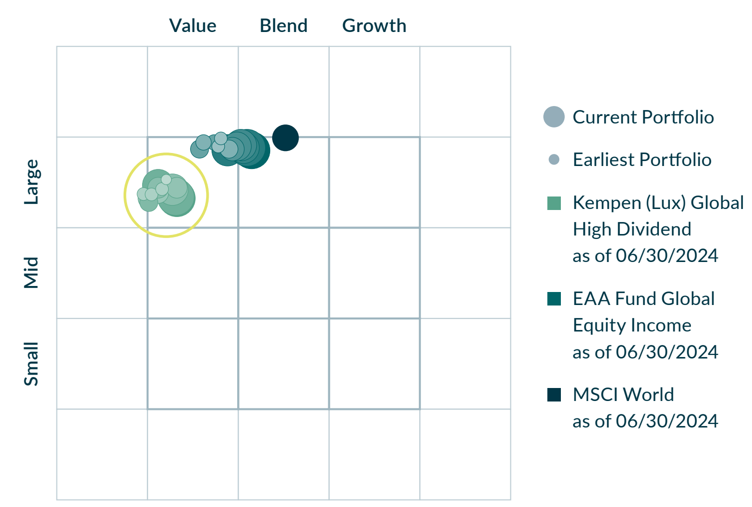
Kempen Global Dividend outside the flock



Source: VLK, Morningstar Direct. Style development for the period June 2019-June 2024.

**Source: Bloomberg*

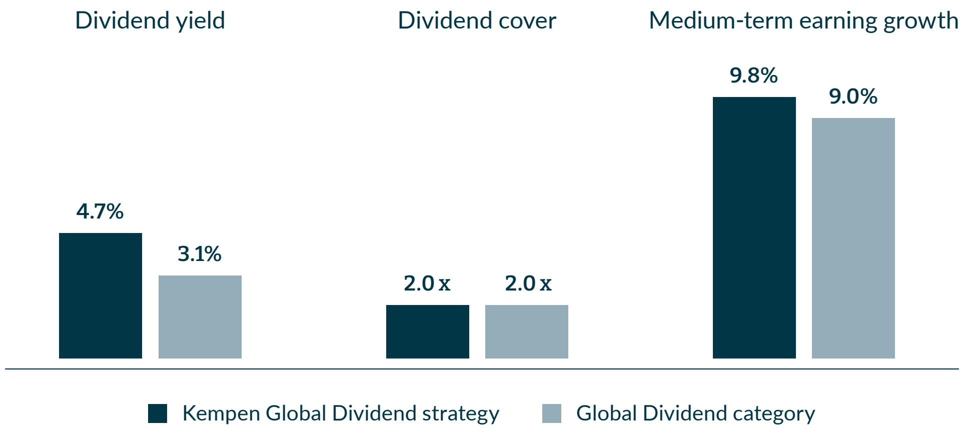
Seeking diversification benefits

In our previous update we wrote about navigating market extremes and the importance of diversification. We showed that betting on the largest companies to outgrow the rest of the market over a long period has historically been an unsuccessful strategy.

Our strategy has always been to look for investment opportunities beyond the beaten path. With that, we aim to uncover the most attractive dividend stocks. Valuations are currently more attractive outside the well-known large-cap names. This leads to exposure to mid-cap stocks, emerging markets players and companies in non-traditional dividend industries. The chart above shows that in terms of exposure to value and size our strategy is differentiated versus the group of dividend funds.

We look for attractive dividend investments among mid-caps where valuations are more favorable and yields are higher. Regionally, we also explore lesser known markets. Finding investment opportunities with attractive yields in countries like South Korea where improvements in corporate governance and capital allocation are unlocking significant value. On a sector basis, we have exposure to companies with solid yields in non-traditional dividend industries. This makes the portfolio more robust in terms of underlying value drivers.

Comparison between Kempen Global Dividend strategy and Global Dividend category



Source: Factset, Morningstar, Dividend cover = dividends covered by earnings, medium-term growth = 3-5yrs consensus earnings growth. August 2024.

Past performance is no guarantee of future returns.

A different offering provides clear diversification benefits. It should however also offer something outstanding in absolute terms as well. By looking at a broader range of opportunities when we construct our portfolio, we concentrate on achieving an attractive yield while maintaining a similar dividend cover ratio. At the same time, our portfolio has slightly higher growth expectations.

Global dividend funds used to have a strong value tilt offering attractive dividend yields. There has been a style drift in recent years, as this group has continued to invest in large-caps with limited dividend yields and steep valuations. As a result, the dividend yield for this group has gone down and they offer less diversification benefits versus the global market. By looking off the beaten path for attractive dividend investment opportunities we aim to offer an attractive dividend yield and a truly diverse portfolio, that lets us stand out from the crowd.

Market Musings authors

Reineke Davidsz
Portfolio Manager

Follow Reineke on LinkedIn

Marius Bakker
Portfolio Manager

Follow Marius on LinkedIn

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1737 VAN LANSCHOT KEMPEN

Beethovenstraat 300
1077 WZ
Amsterdam
Netherlands

vanlanschotkempen.com/investment-management

Follow us on LinkedIn