Creating wealth through dividends

All too often, dividend investing is associated with older investors who seek more conservative equity exposure and are in need of the cash flow generated from dividends to help fund retirement. While this is true, we believe dividend investing is appropriate for all investors and that investing for total return is a great way for younger investors to create wealth over time, since time is on their side.

Over the long term, dividends have played a significant role in the returns investors have received. Over the past 50 years, 72% of the total return of the S&P 500 Index can be attributed to reinvested dividends and the power of compounding.

Dividend-paying stocks are not guaranteed to outperform non-dividend-paying stocks, sometimes they do not. However, as the chart on the left shows, dividend-paying stocks have been a solid way to create wealth over time.

**Dividend contribution by decade**

If we look at the S&P 500 Index performance on a decade-by-decade basis going back to the 1940s, we see how dividends’ contribution varied greatly.

Dividends played a significant role in total returns during the 1940s, 1960s, and 1970s, decades in which total returns for the S&P 500 were below 10%. Dividends played a less significant role during the 1950s, 1980s, and 1990s when

---


![Graph showing S&P 500 total return and price return from 1970 to 2020, with shaded areas indicating dividend contribution.]

**Dividend contribution to S&P 500 Index total return**

<table>
<thead>
<tr>
<th>Decade</th>
<th>Dividend Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>1941–1950</td>
<td>62%</td>
</tr>
<tr>
<td>1951–1960</td>
<td>47%</td>
</tr>
<tr>
<td>1961–1970</td>
<td>50%</td>
</tr>
<tr>
<td>1971–1980</td>
<td>62%</td>
</tr>
<tr>
<td>1981–1990</td>
<td>47%</td>
</tr>
<tr>
<td>1991–2000</td>
<td>25%</td>
</tr>
<tr>
<td>2001–2010</td>
<td>131%</td>
</tr>
<tr>
<td>2011–2019</td>
<td>24%</td>
</tr>
</tbody>
</table>

Dividend contribution exceeded 100% from 2001–2010 because price returns were negative.

---

Source - RBC Wealth Management, Bloomberg; monthly data through 12/31/19

Source - Source: RBC Wealth Management, RBC Capital Markets, FactSet

Click [here](#) for author’s contact information. Priced (in USD) as of 7/20/20 market close, ET (unless otherwise stated). For important disclosures see page 5. Produced: July 22, 2020 15:11ET; Disseminated: July 23, 2020 16:00ET

Investment and insurance products offered through RBC Wealth Management are not insured by the FDIC or any other federal government agency, are not deposits or other obligations of, or guaranteed by, a bank or any bank affiliate, and are subject to investment risks, including possible loss of the principal amount invested.
average annual total returns for those decades were well into double digits.

During the 1990s, the great tech decade, many companies de-emphasized dividends as management teams determined they were better able to deploy capital by reinvesting it in their businesses instead of returning it to shareholders. Significant year-over-year capital appreciation during that decade caused many investors to shift away from dividends, in favor of growth.

Investor sentiment changed in the first decade of the 2000s, a period that saw the dot.com bubble, the financial crisis, and the start of a secular bear market for equities. The S&P 500 actually finished the decade lower based on price only than where it started. If you were a buy-and-hold investor that decade and not actively trading, your positive returns in the index came from dividends.

**Highest yield doesn’t necessarily provide the best returns**

Often times, investors seeking dividend-paying investments make the mistake of buying purely based on yield, thinking higher is better. Wellington Management did a study that showed some potential flaws in that train of thought. The Wellington study found that stocks paying the highest level of dividend payouts and highest yields have performed well over time, but not as well as those that pay high, but not the very highest, levels of dividend payouts and yields.

The Wellington study started by dividing dividend-paying stocks in the S&P 500 into quintiles by their level of dividend payouts/yields. The first quintile, the top 20%, consisted of the highest dividend payers, while the fifth quintile, the bottom 20%, consisted of the lowest payers and no payers. Its study tracked the performance by quintile for each decade from 1930 through 2019. The results are reflected in the table below.

The second-quintile stocks outperformed the S&P 500 seven out of the nine time periods (77.8%), while the first- and third-quintile stocks tied for second, outperforming the index six out of nine time periods (66.7%). Fourth- and fifth-quintile stocks lagged, outperforming four times each (44.4%).

**Dividend payout ratios matter**

One reason second-quintile dividend stocks outperformed the first is dividend payout ratios. One of the best ways to measure whether a company will be able to pay a consistent dividend is through the payout ratio. A high payout ratio means a company is using a significant percentage of its earnings to pay a dividend, leaving it with

---

**Dividend-paying stocks beat the market nearly every decade**

CAGR (%) for U.S. portfolios by dividend yield quintile by decade, 1930–2019

<table>
<thead>
<tr>
<th></th>
<th>S&amp;P 500</th>
<th>1st Quintile</th>
<th>2nd Quintile</th>
<th>3rd Quintile</th>
<th>4th Quintile</th>
<th>5th Quintile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan. 1930–1939</td>
<td>-0.20%</td>
<td>-1.22%</td>
<td>0.40%</td>
<td>-2.21%</td>
<td>-0.65%</td>
<td>2.00%</td>
</tr>
<tr>
<td>Jan. 1940–1949</td>
<td>9.51%</td>
<td>13.92%</td>
<td>13.06%</td>
<td>10.26%</td>
<td>8.63%</td>
<td>6.83%</td>
</tr>
<tr>
<td>Jan. 1950–1959</td>
<td>18.33%</td>
<td>18.52%</td>
<td>20.31%</td>
<td>18.47%</td>
<td>16.57%</td>
<td>19.81%</td>
</tr>
<tr>
<td>Jan. 1960–1969</td>
<td>8.26%</td>
<td>8.82%</td>
<td>8.90%</td>
<td>6.45%</td>
<td>7.96%</td>
<td>9.32%</td>
</tr>
<tr>
<td>Jan. 1970–1979</td>
<td>6.05%</td>
<td>9.67%</td>
<td>10.23%</td>
<td>7.00%</td>
<td>7.57%</td>
<td>3.94%</td>
</tr>
<tr>
<td>Jan. 1990–1999</td>
<td>17.96%</td>
<td>12.35%</td>
<td>15.57%</td>
<td>15.07%</td>
<td>18.07%</td>
<td>18.92%</td>
</tr>
<tr>
<td>Jan. 2000–2009</td>
<td>-0.44%</td>
<td>4.91%</td>
<td>4.57%</td>
<td>4.48%</td>
<td>1.91%</td>
<td>-1.77%</td>
</tr>
</tbody>
</table>

Source - Professor Kenneth French, Dartmouth College, http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/; data compiled by Wellington Management. U.S. stocks are represented by the S&P 500 Index, which is a composite of the 500 largest companies in the U.S. The Index is unmanaged and not available for direct investment. Data through 12/31/19
less money to invest in future growth of the business. In addition, excessive dividend payout ratios are not always sustainable and can potentially put dividends at risk, should company fundamentals deteriorate. Going back to 1979, the first-quintile dividend payout ratio has averaged just north of 70%, while the second-quintile payout ratio has averaged just over 40%.

A payout ratio of 70% or greater could be difficult to sustain if a company experiences an earnings decline, which might, in turn, force a company to cut its dividend. Investors often view a dividend cut as a sign of weakness, often resulting in a significant share price drop.

Dividend policies and stock performance

A study done by Ned Davis Research (NDR) shows that dividend policy has a significant impact on share price performance. The study first divided the companies in the S&P 500 into two groups based on whether or not they paid a dividend during the prior 12 months. These groups were labeled “Dividend Payers” and “Dividend Non-Payers.”

The “Dividend Payers” were then divided into three groups based on their prior 12-month dividend payout policy. Companies that maintained their dividends at the same level were classified as “No Change.” Companies that increased their dividends or initiated a new dividend were classified as “Dividend Growers & Initiators.” Companies that lowered or eliminated their dividends were classified as “Dividend Cutters & Eliminators.” Companies remained in these categories for the next 12 months and then were reviewed and adjusted annually based upon their dividend policy action.

For performance tracking, NDR calculated the geometric total-return average for each of the five categories and rebalanced monthly to smooth out performance and create a level playing field.

The chart clearly shows that “Dividend Growers & Initiators” was the best-performing group, while the “Dividend Cutters & Eliminators” was the worst.

Low interest rates and demographics—both tailwinds for dividend-paying stocks

With bond yields near historically low levels and expected to remain low, per our research sources, we believe dividend-paying stocks are becoming more appealing to investors seeking income. With the baby boomer generation at or near retirement, demand for income-producing investments is on the rise and many investors are favoring stocks over bonds. Given bond yields are expected to remain low, we think demand for dividend-paying stocks will remain strong as the aging population needs to help fund its retirement.

Growing dividends provide growing cash flows

A growing cash flow stream should be important for retirees and growing dividends provide it. For example, if an investor bought 1,000 shares of ABC Corp. that pays a $1 per share dividend, at the end of one year he or she would have $1,000 of income. If ABC can grow its dividend at a 7.2% annualized rate, after 10 years the original investment will generate $2,000 in dividend income. If the same can be done for another 10 years, the original investment will generate $4,000 in dividend income. In 20 years, the income stream will have quadrupled from the original investment.
Why we believe investing in dividend-paying and dividend-growing companies makes sense

Dividends have historically played a significant role in total return for investors, especially during periods when market returns have been below double digits for extended periods of time.

Companies that have consistently grown their dividends and companies initiating a dividend policy have historically provided greater total return with less volatility versus companies that either maintained or cut their dividends.

The current environment, including baby boomers’ need for cash to help fund retirement, historically low interest rates, and high levels of corporate cash on balance sheets, in our opinion, bodes well for demand for dividend-paying and dividend-growing stocks. Plus, for younger investors, owning stocks of dividend-paying, dividend-growing companies and reinvesting the dividends is a great way to create wealth for the long run.
Explanation of RBC Capital Markets, LLC Equity Rating System

An analyst’s “sector” is the universe of companies for which the analyst provides research coverage. Accordingly, the rating assigned to a particular stock represents solely the analyst’s view of how that stock will perform over the next 12 months relative to the analyst's sector average.

Ratings:
Outperform (O): Expected to materially outperform sector average over 12 months. Sector Perform (SP): Returns expected to be in line with sector average over 12 months. Underperform (U): Returns expected to be materially below sector average over 12 months. Restricted (R): RBC policy precludes certain types of communications, including an investment recommendation, when RBC is acting as an advisor in certain merger or other strategic transactions and in certain other circumstances. Not Rated (NR): The rating, price targets and estimates have been removed due to applicable legal, regulatory or policy constraints which may include when RBC Capital Markets is acting in an advisory capacity involving the company.

As of March 31, 2020, RBC Capital Markets discontinued its Top Pick rating. Top Pick rated securities represented an analyst’s best idea in the sector; expected to provide significant absolute returns over 12 months with a favorable risk-reward ratio. Top Pick rated securities have been reassigned to our Outperform rated securities category, which are securities expected to materially outperform sector average over 12 months.

Risk Rating:
The Speculative risk rating reflects a security’s lower level of financial or operating predictability, illiquid share trading volumes, high balance sheet leverage, or limited operating history that result in a higher expectation of financial and/or stock price volatility.

Valuation and Risks to Rating and Price Target

When RBC Wealth Management assigns a value to a company in a research report, FINRA Rules and NYSE Rules (as incorporated into the FINRA Rulebook) require that the basis for the valuation and the impediments to obtaining that valuation be described. Where applicable, this information is included in the text of our research in the sections entitled “Valuation” and “Risks to Rating and Price Target”, respectively.

The analyst(s) responsible for preparing this research report have received (or will receive) compensation that is based upon various factors, including total revenues of RBC Capital Markets, LLC, and its affiliates, a portion of which are or have
been generated by investment banking activities of RBC Capital Markets, LLC and its affiliates.

**Other Disclosures**
Prepared with the assistance of our national research sources. RBC Wealth Management prepared this report and takes sole responsibility for its content and distribution. The content may have been based, at least in part, on material provided by our third-party correspondent research services. Our third-party correspondent has given RBC Wealth Management general permission to use its research reports as source materials, but has not reviewed or approved this report, nor has it been informed of its publication. Our third-party correspondent may from time to time have long or short positions in, effect transactions in, and make markets in securities referenced herein. Our third-party correspondent may from time to time perform investment banking or other services for, or solicit investment banking or other business from, any company mentioned in this report.

RBC Wealth Management endeavors to make all reasonable efforts to provide research simultaneously to all eligible clients, having regard to local time zones in overseas jurisdictions. In certain investment advisory accounts, RBC Wealth Management or a designated third party will act as overlay manager for our clients and will initiate transactions in the securities referenced herein for those accounts upon receipt of this report. These transactions may occur before or after your receipt of this report and may have a short-term impact on the market price of the securities in which transactions occur. RBC Wealth Management research is posted to our proprietary Web sites to ensure eligible clients receive coverage initiations and changes in rating, targets, and opinions in a timely manner. Additional distribution may be made by sales personnel via e-mail, fax, or regular mail. Clients may also receive our research via third-party vendors. Please contact your RBC Wealth Management Financial Advisor for more information regarding RBC Wealth Management research.

**Conflicts Disclosure:** RBC Wealth Management is registered with the Securities and Exchange Commission as a broker/dealer and an investment adviser, offering both brokerage and investment advisory services. RBC Wealth Management’s Policy for Managing Conflicts of Interest in Relation to Investment Research is available from us on our website at [https://www.rbccm.com/GLDisclosure/PublicWeb/DisclosureLookup.aspx?EntityID=2](https://www.rbccm.com/GLDisclosure/PublicWeb/DisclosureLookup.aspx?EntityID=2). Conflicts of interests related to our investment advisory business can be found in Part 2A Appendix 1 of the Firm’s Form ADV or the RBC Advisory Programs Disclosure Document. Copies of any of these documents are available upon request through your Financial Advisor. We reserve the right to amend or supplement this policy, Part 2A Appendix 1 of the Form ADV, or the RBC Advisory Programs Disclosure Document at any time.

The authors are employed by one of the following entities: RBC Wealth Management USA, a division of RBC Capital Markets, LLC, a securities broker-dealer with principal offices located in Minnesota and New York, USA; and by RBC Dominion Securities Inc., a securities broker-dealer with principal offices located in Toronto, Canada.

**Research Resources**
This document is produced by the Global Portfolio Advisory Committee within RBC Wealth Management’s Portfolio Advisory Group. The RBC WM Portfolio Advisory Group provides support related to asset allocation and portfolio construction for the firm’s Investment Advisors / Financial Advisors who are engaged in assembling portfolios incorporating individual marketable securities. The Committee leverages the broad market outlook as developed by the RBC Investment Strategy Committee, providing additional tactical and thematic support utilizing research from the RBC Investment Strategy Committee, RBC Capital Markets, and third-party resources.

**Third-party disclaimers**
The Global Industry Classification Standard (“GICS”) was developed by and is the exclusive property and a service mark of MSCI Inc. ("MSCI") and Standard & Poor's Financial Services LLC ("S&P") and is licensed for use by RBC. Neither MSCI, S&P, nor any other party involved in making or compiling the GICS or any GICS classifications makes any express or implied warranties or representations with respect to such standard or classification (or the results to be obtained by the use thereof), and all such parties hereby expressly disclaim all warranties of originality, accuracy, completeness, merchantability and fitness for a particular purpose with respect to any such standard or classification. Without limiting any of the foregoing, in no event shall MSCI, S&P, any of their affiliates or any third party involved in making or compiling the GICS or any GICS classifications have any liability for any direct, indirect, special, punitive, consequential or any other damages (including lost profits) even if notified of the possibility of such damages.

References herein to “LIBOR”, “LIBO Rate”, “L” or other LIBOR abbreviations means the London Interbank offered rate as administered by ICE Benchmark Administration (or any other person that takes over the administration of such rate).

**Disclaimer**
The information contained in this report has been compiled by RBC Wealth Management, a division of RBC Capital Markets, LLC, from sources believed to be reliable, but no representation or warranty, express or implied, is made by Royal Bank of Canada, RBC Wealth Management, its affiliates or any other person as to its accuracy, completeness or correctness. All opinions and estimates contained in this report constitute RBC Wealth Management’s judgment as of the date of this report, are subject to change without notice and are provided in good faith but without legal responsibility. Past performance is not a guide to future performance, future returns are not guaranteed, and a loss of original capital may occur. Every province in Canada, state in the U.S., and most countries throughout the world have their own laws regulating the types of securities and other investment products which may be offered to their residents, as well as the process for doing so. As a result, the securities discussed in this report may not be eligible for sale in some jurisdictions. This report is not, and under no circumstances should be construed as, a solicitation to act as securities broker or dealer in any jurisdiction by any person or company that is not legally permitted to carry on the business of a securities broker or dealer in that jurisdiction. Nothing in this report constitutes legal, accounting or tax advice or individually tailored investment advice. This material is prepared for general circulation to clients, including clients who are affiliates of Royal Bank of Canada, and does not have regard to the particular circumstances or needs of any specific person who may read it. The investments or services contained in this report may not be suitable for you and it is recommended that you consult an independent investment advisor if you are in doubt about the suitability of such investments or services. To the full extent permitted by law neither Royal Bank of Canada nor any of its affiliates, nor any other person, accepts any liability whatsoever for any direct, indirect or consequential loss arising from, or in connection with, any use of this report or the information contained herein. No matter contained in this document may be reproduced or copied by any means without the prior written