Client's Corner

The Seriously Underappreciated Power of Dividend Growth

READERS OF THESE LITTLE ESSAYS MAY ALREADY BE AWARE that your correspondent (and family) are big fans of dividend growth in mainstream equities. I'm starting to think that perhaps I didn't know the half of it.

The basics, I think, are fairly well known. To wit: since 1926, inflation as measured by the Consumer Price Index has compounded at an average annual three percent rate, sapping the purchasing power of America's increasingly longer-lived retirees—not to mention future retirees, who will need a lifestyle-sustaining income from their investments to support even longer retired lives.

One effective long-term weapon against the ravages of inflation has been the steadily rising dividends of high quality common stocks. Indeed, again starting from 1926, the dividend of the Standard & Poor's 500-Stock Index (and its predecessor prior to 1957, the S&P 90) has compounded at an average annual five percent.

So for just one example, suppose you and your spouse had just turned 50, and were beginning to think really hard about finding a retirement income stream that had historically offset inflation (and then some). You might be interested in the following scoreboard that spans your whole life so far:

	1973	2023E	Change
S&P cash dividend	**$3.61**	**$70**E	**19X**
CPI* (yearend)	**46**	**310**E	**7X**

*Consumer Price Index

Note that we aren't talking here about current yield, which is irrelevant. We are inquiring pointedly and specifically as to how much the cost of living went up in the lifetime of today's 50-year-olds, and how much the cash dividend income of a mainstream equity investor might have grown to offset it—and then some. By all means, ask your financial advisor to run this juxtaposition for any time period you choose. I expect he/she will be tickled pink to do so for you.

(Not to clutter up this conversation with data that are extraneous to the point here, but permit me to just quietly read into the record the fact that the S&P 500 Index itself—the price—went from 98 at yearend 1973 to about 4,300 as I write. Feel free to ignore this.)

Now, the more eagle-eyed and/or analytical reader may already be saying, "Just hold on there, old timer, but that dividend increase looks a skosh higher than your five percent to me." You've discovered one (of two) pretty nifty attributes of more recent dividend growth—one that frankly had to be pointed out to me. Namely that since 1950 the rate of dividend growth has accelerated to an average annual 5.7%.

Wait, there's more: since 1980, the rate of growth of the S&P 500's cash dividend has increased even further, to 5.9% a year—or twice the rate of CPI inflation over the same period. I wouldn't have thought it could do that.

You see, it's just since 1980 that the new phenomenon of large scale share repurchases has come into fashion in American corporation finance. And you'd have thought—well, ***I'd*** certainly have thought—that corporate cash that had previously gone into dividends might well have been diverted into stock buybacks. If anything, dividend growth might thus have even slowed. That hasn't happened—at least not yet. I find that remarkable.

The other interesting attribute of dividend trends I stumbled upon recently (this one all on my own, as unlikely as that may seem) is that it has, over time, been taking a smaller share of corporate earnings to fund the accelerating dividend growth.

Using the same time frame as our example, we find that the $3.61 dividend in 1973 took a little over 45% of that year's earnings (of $7.96) to pay. If in fact this year's dividend is $70—and if the current consensus earnings estimate of about $220 turns out to be right—the payout ratio will be down to 32%. One may have to be some kind of serious dividend nerd to get excited about this. If so, you've got me. And did I mention that in 2022—a year in which the S&P 500 declined 18%—its cash dividend actually went up 11%?

My bottom line is that dividend growth should become even more important to people as their retired lives get longer—and as inflation besieges their purchasing power that much longer as well. I know I've said this before, but: if we all checked our cash dividend income every 90 days instead of our account values every 90 minutes, we might all become better investors.

We'd almost certainly be calmer.

Sources: Earnings and dividend actual statistics: Standard & Poor's, NYU Stern School. Inflation: US Bureau of Labor Statistics, inflationdata.com. Full year 2023 estimates are mine, based on upwards of 10 months of actual data.