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Why dividend growth?

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As inflationary pressures persist and monetary policy remains tight, we believe it is an ideal time to reassess the benefits of dividend growth investing within a diversified portfolio. Dividend growers have historically outperformed non-dividend paying companies, with less volatility. Companies with persistent dividend growth have provided competitive returns during periods of market volatility. And with inflation still running higher than average, a dividend growth-oriented portfolio may provide a slight hedge against rising costs while providing an attractive level of income with potential for growth.

DIVIDEND GROWTH STOCKS HAVE OUTPERFORMED IN VARIOUS MARKET ENVIRONMENTS

Dividend growth stocks have provided an attractive combination of earnings and cash flow growth potential, healthy balance sheets and sustainable dividend policies. These stocks have historically offered compelling performance during up markets and provided a buffer during market drawdowns and in volatile environments.

Over the long term, dividend growers and initiators have generated higher returns with less risk, measured by standard deviation, than companies that maintained their dividends, paid no dividend and reduced or eliminated their dividends (Figure 1).

Additionally, while dividends are not guaranteed and will fluctuate, they have contributed significantly to equity total return over the decades. In fact, from 1930 to 2022, 41% of the annualized total return of the S&P 500® was derived from the payment and reinvestment of dividends, with capital appreciation contributing the rest (Figure 2).

Dividends have contributed significantly to equity total return over the decades.

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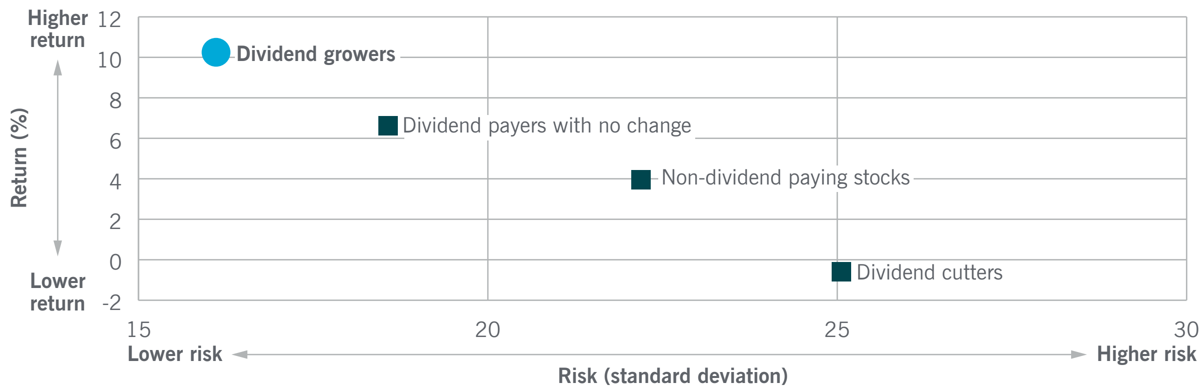
NOT FDIC INSURED | NO BANK GUARANTEE | MAY LOSE VALUE

Figure 1: Dividend growth stocks have outperformed with less risk

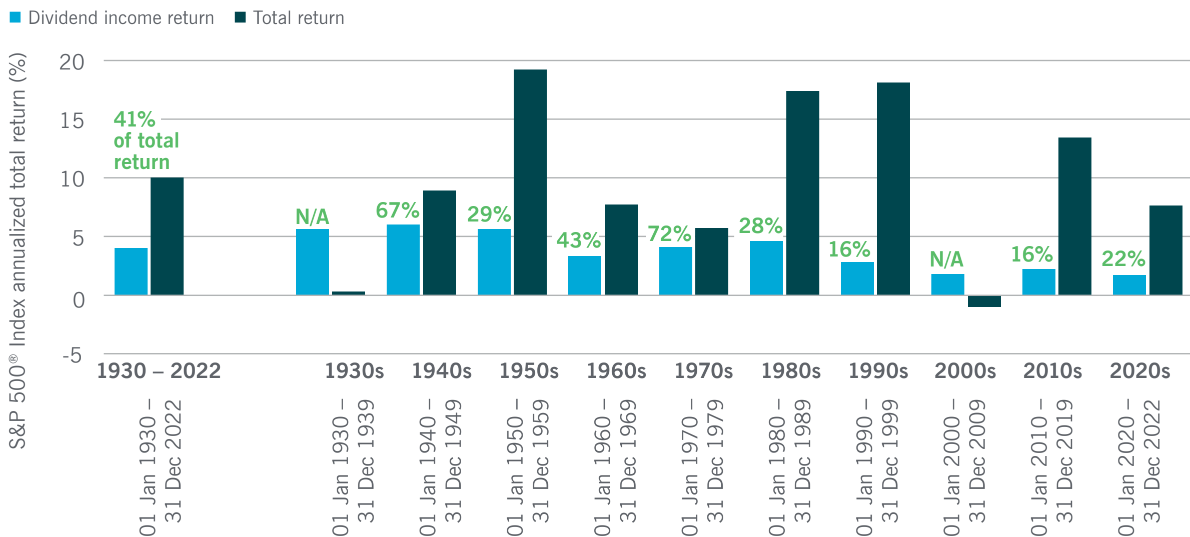
Risk vs return, annualized, 1973 – 2022



Data source: Ned Davis Research, Inc. and Refinitiv, 31 Jan 1973 – 31 Dec 2022. Further distribution prohibited without prior permission. Copyright 2023 © Ned Davis Research, Inc. All rights reserved. **Performance data shown represents past performance and does not predict or guarantee future results.** Performance represents the historical risk/return performance of S&P 500 stocks grouped by dividend policies. For more information, see the Dividend Policy Description on the last page.

Figure 2: Dividends have been a significant component of total return

Dividend income as percentage of total return



Data source: Ned Davis Research, Inc., 31 Dec 2022. Further distribution prohibited without prior permission. Copyright 2023 © Ned Davis Research, Inc. All rights reserved. **Performance data shown represents past performance and does not predict or guarantee future results.** The analysis provided by Ned Davis indicates that the data is not applicable because the Dividend Income Return data for the 1930s and 2000s is disproportionately high versus the other decades due to the low or negative total returns during these periods. The information provided in this analysis may not represent the full value of reinvested dividends. For more information, see the Endnotes for Figure 2 on the last page.

The income produced by dividends may be an essential complement to a strong capital appreciation strategy, as it may limit volatility and contribute to total return over time. Market volatility can cause swings in the price return of a portfolio, but the performance of companies with healthy balance sheets and the financial strength necessary to support dividend growth can help mitigate volatility (Figure 3).

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Figure 3: Dividend growers have provided excess returns during market volatility

Excess returns during months when volatility increased (%)

VIX monthly increase	Average out/under performance of dividend growers vs. non-dividend payers
>20	0.96
10-20	1.03
<10	0.42
Average (Across all months when VIX Increased)	0.78

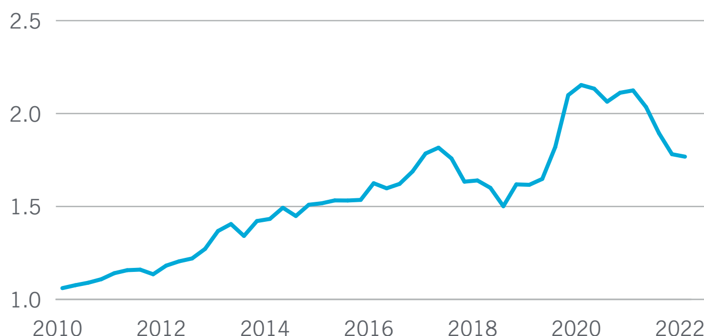
Data source: Ned Davis Research, Inc., 31 Dec 2002 – 31 Dec 2022. Further distribution prohibited without prior permission. Copyright 2023 © Ned Davis Research, Inc. All rights reserved. **Performance data shown represents past performance and does not predict or guarantee future results.** Periods greater than one year have been annualized. For more information, see the Dividend Policy Description on the last page.

DIVIDENDS CAN BE AN IMPORTANT CHECK ON CORPORATE GOVERNANCE AND FINANCIAL HEALTH

Management teams allocate capital based on a belief that the payoff will provide a positive net present value. A sound capital allocation plan, which includes paying and growing dividends, can indicate a management team's commitment to their shareholders. Companies are currently sitting on a near record pile of cash and liquid assets and they are increasingly putting that cash back into the hands of investors in the form of dividends.

Figure 4: High corporate cash levels are funding dividend payments

Corporate cash levels ($ trillions)



Data sources: FactSet and S&P Dow Jones Indexes, 30 Sep 2010 – 30 Sep 2022. **Performance data shown represents past performance and does not predict or guarantee future results.** Most recent quarter-end data available based on individual company earnings releases. Corporate cash levels and dividends paid are represented by nonfinancial companies in the S&P 500.

A COMBINATION OF DIVIDEND YIELD AND GROWTH MAY PROVIDE OPTIMAL OUTCOMES

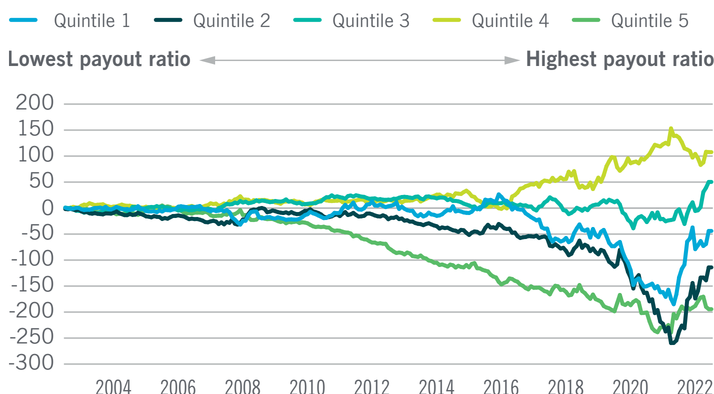
While dividend-paying stocks have provided compelling long-term performance (Figure 1), not all dividend stocks are the same. Dividend-paying stocks with a combination of yield and consistent dividend growth can indicate quality, given their ability to balance dividend payments with additional capital reinvestment for future growth initiatives.

A firm's dividend payout ratio is a key indicator of dividend policy flexibility. Companies earning just enough to pay dividends or paying most of their earnings as dividends may be vulnerable to competitive pressure, as cash flow may be insufficient to support operations. In addition, a company with a high dividend yield, or more importantly, high payout ratios, may be at risk of low growth in the future that could threaten both share price appreciation and dividend growth.

Historically, stocks with the highest payout ratio (Quintile 5) have not been the best long-term performers. Among those companies that paid a dividend over the past 20 years, stocks with medium and medium-high payout ratios (Quintiles 3 and 4) have outperformed.

Figure 5: The highest payout ratios don't make the best performers

Excess return relative to the S&P 500 (%)



Data source: FactSet Fundamentals via FactSet Alpha Testing, 31 Dec 2002 – 31 Dec 2022. **Performance data shown represents past performance and does not predict or guarantee future results.** The chart illustrates the historical performance of S&P 500 dividend-paying stocks grouped by dividend payout ratio quintiles. Quintile 1 represents the lowest payout ratio and Quintile 5 the highest. The returns do not reflect the deduction of any fees, expenses or taxes, and assume reinvestment of all income.

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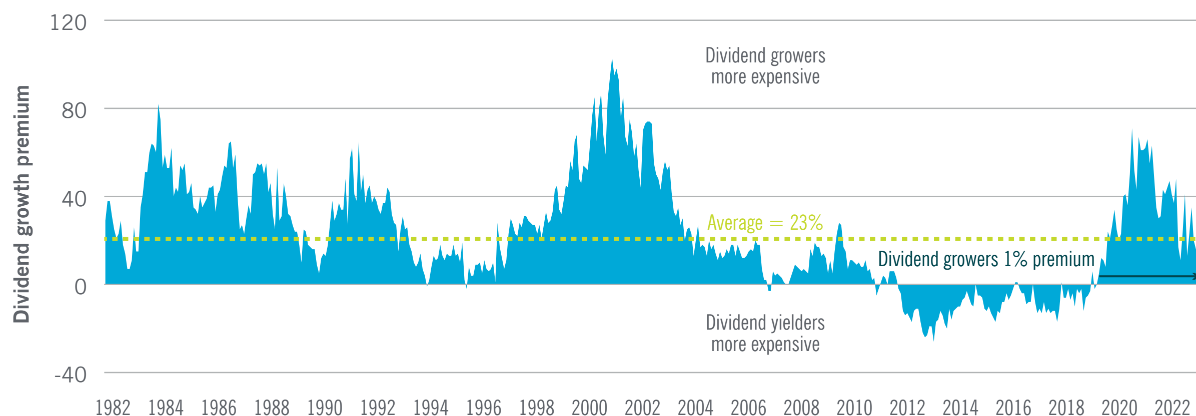
VALUATIONS OF DIVIDEND GROWERS REMAIN ATTRACTIVE

Not all dividend paying companies are alike. We favor those with sustainable payout ratios, healthy balance sheets and a good track record of capital allocation that includes returning capital to shareholders in the form of a growing dividend. Higher-yielding companies outperformed their lower-yielding counterparts in 2022, primarily due to recession fears and the strength of the energy sector. These factors prompted a flight to defensive areas such as utilities, consumer staples and health care. With persistent inflation and higher interest rates likely to continue squeezing profit margins in 2023, we think investors can best temper risks by emphasizing fundamentals and companies with sustainable dividend growth potential.

Compared to high dividend yielding companies, dividend growing companies tend to have better earnings growth potential, lower dividend payout ratios, higher profitability metrics and less reliance on the debt market. All of these factors tend to help mitigate risk during periods of heightened volatility. Moreover, dividend growing companies offer these advantages while trading at an attractive valuation relative to high dividend yielders (Figure 6). A higher dividend yield might be appealing, but we favor companies with sustainable dividend growth potential given their ability to continue to grow earnings, generate substantial free cash flow and maintain healthy balance sheets. We believe these characteristics better position dividend growers to navigate current market headwinds and provide greater consistency over the long term.

Figure 6: High dividend growth companies are attractively valued

Relative forward P/E of high dividend growers vs high dividend yielders (%)



Data source: Ned Davis Research, Inc., 30 Jun 1981 – 31 Dec 2022. Data shown based on inception of Ned Davis tracking. Further distribution prohibited without prior permission. Copyright ©Ned Davis Research, Inc. All rights reserved. **Performance data shown represents past performance and does not predict or guarantee future results.** Based on top quintile of median forward P/E. **Dividend growth** premium = (dividend growth/dividend yield)-1. Dividend growers include those companies that comprise the top 20% of dividend growth in the S&P 500. **Dividend yielders** include those companies that comprise the top 20% of dividend yield in the S&P 500.

DIVIDEND GROWERS HAVE PERFORMED WELL AFTER INTEREST RATE INCREASES

The U.S. Federal Reserve and U.S. government provided extraordinary levels of monetary and fiscal stimulus to help boost the economy in the wake of the Covid pandemic. The Fed started raising rates in 2022 at a historically aggressive pace that is finally beginning to slow in early 2023. The U.S. equity markets have performed well in previous tightening cycles (Figure 7). Historically, dividend growers and initiators have outperformed the other cohorts of the S&P 500 after the Fed has increased interest rates.

With higher interest rates in mind, we believe investors should focus on dividend paying companies supported by positive fundamentals, balance sheet strength, ample free cash flow and management teams committed to sustainable dividend growth. On the contrary, higher yielding sectors with high debt levels might be challenged given their interest rate sensitivity.

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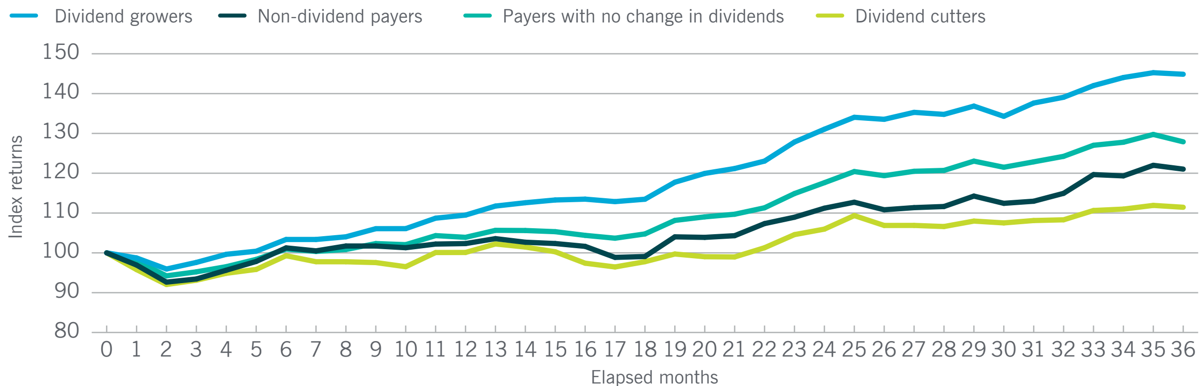
Figure 7: Dividend growers have provided compelling performance after rate increases



Data source: Ned Davis Research Inc. and Refinitiv. Further distribution prohibited without prior permission. Copyright 2023 © Ned Davis Research, Inc. All rights reserved. **Performance data shown represents past performance and does not predict or guarantee future results.** Data based on the average performance after all rate hikes since 1973, which occurred on 31 Aug 1977, 30 Sep 1980, 31 Mar 1984, 31 Aug 1987, 31 Jan 1994, 31 Mar 1997, 30 Jun 1999, 30 Jun 2004 and 31 Dec 2015. For a description of how each stock is grouped by dividend policy, see Endnotes for Figure 7 on the last page.

DIVIDEND GROWERS MAY BE AN IMPORTANT PART OF A DIVERSIFIED PORTFOLIO

We believe many companies are well positioned to continue increasing their dividends over the long term. Fueled by strong earnings growth and the reinstatement of suspended dividend policies from 2020, the S&P 500 experienced 10% growth in dividends per share in 2022. Looking forward, S&P 500 dividends per share are expected to grow by 5% in 2023 with the fastest growth coming from the industrials, consumer discretionary, financials and information technology sectors.

Companies continue to maintain high levels of cash on their balance sheets, with balances of $1.8 trillion as of 30 Sep 2022 near their highest levels in two decades. Additionally, with equity market valuations above their long-term averages, we believe corporate management teams may be inclined to focus more on dividend growth as a means of rewarding shareholders in 2023, as opposed to stock buybacks, given the higher valuations.

Investing in companies with sustainable dividend growth can help augment total returns and reduce volatility while providing a growing income stream. Dividend growth oriented companies have historically participated in up markets and helped to mitigate risk during periods of heightened volatility and market drawdowns. The combination of strong capital flexibility and growing dividend payments may help mitigate inflationary pressures and the impact of higher interest rates.

Ultimately, we believe these characteristics create a compelling reason to consider companies with strong balance sheets and the fundamental strength for future dividend growth as part of a diversified portfolio.

For more information, please visit nuveen.com.

Endnotes

Dividend Policy Description (Figures 1, 3 and 7) The performance of each group is based on the equal-weighted geometric average of dividend-paying and non-dividend-paying historical S&P 500 stocks, rebalanced monthly. Each stock's dividend policy is determined on a rolling 12-month basis. For example, a stock is classified as dividend-paying if it paid a cash dividend at any time during the previous 12 months. A stock is reclassified only if its dividend payments change. Dividend growers and initiators include stocks that raised their existing dividend or initiated a new dividend during the preceding 12 months. Dividend cutters or eliminators include stocks that lowered their existing dividend or stopped paying regular dividends during the preceding 12 months. The returns do not reflect the deduction of any fees, expenses or taxes that would reduce performance in an actual client portfolio. Returns for stocks that paid dividends assume reinvestment of all income. The periods shown do not represent the full history of the S&P 500; it is the history maintained by the data source. It is not possible to invest in an index. These groups have been determined by Ned Davis Research, Inc. Further distribution of this information is prohibited without prior permission. Copyright 2023 © Ned Davis Research, Inc. All rights reserved.

Figure 2 Periods greater than one year are annualized. The S&P 500 is a capitalization-weighted index of 500 stocks designed to measure the performance of the broad domestic stock market. The S&P 500 in its present form began on 04 Mar 1957. Prior to the 500 Composite, from 1923 to 1926 S&P used as its first broad market indicator a composite index of 233 stocks. In 1926, to disseminate market indicator information more frequently, S&P created a more manageable subset of stocks that became known as the S&P 90 Stock Composite Index. Prices for the 500 Composite were linked to the 90 Stock Composite to provide daily records back to 1928 and monthly data back to 31 Dec 1925. Return performance is based on equal-weighted geometric average, computed monthly. Dividend income return is based on the return percentage of all dividend-paying companies in the S&P 500. The returns do not reflect the deduction of any fees, expenses or taxes, and assume reinvestment of all income. Investors cannot invest in an index. Further distribution of this information is prohibited without prior permission. Copyright 2023 © Ned Davis Research, Inc. All rights reserved.

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