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Q&A: What's driving dividends in 2018?

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As investors contemplate a potentially more turbulent year ahead, we asked portfolio managers Deborah Bickerstaff and Jared Hoff for their outlook for dividend-focused strategies in the U.S. and abroad.

Q: What is the outlook for dividend investing in 2018? On an absolute basis, the outlook is very positive for a number reasons. Impacts from deregulation and tax cuts are supportive. Another aspect of tax reform is the prospect for repatriation of cash that has been parked overseas. Each of these factors supports companies' abilities to cover their dividend obligations and increase future dividend payments.

However, on a relative basis, there's a slight caveat. If we see a continuation of a "risk-on" trade in the U.S. market, it is likely that dividend investments—while still positive—would lag the more growth-oriented sectors such as Tech, Information Technology and Consumer Discretionary.

Following a year of historically low volatility, the recent pullback is a reminder that markets can and likely will become somewhat bumpier in the years ahead. Volatility is a normal part of investing. Stocks selected for their high-quality income historically have experienced less volatility during periods of market turbulence. Their relative stability has been attributable to their strong, mature business profiles, along with their solid balance sheets and ample free cash flow generation. Such reliable business models have enabled these companies to prudently increase their dividends over time.

Q: Will rising rates have an impact on dividend payments? First, we don't expect rates to rise in a dramatic fashion over a short period of time. This would negatively impact the broad market, not just dividend stocks. Nonetheless, dividend-paying stocks are often viewed as a lightning rod in a rising-rate environment, so it's important to distinguish between short-term effects for individual companies versus long-term overall effects.

Short term, hedge funds and traders tend to pull away from dividend-paying stocks on any announcement of a federal funds rate hike. But longer term, a return to a more normalized rate environment is healthy for the economy, the market and for dividend-paying companies. That's especially true for companies that provide necessary goods and services—household products, shelf-stable food, pharmaceuticals, telecom services and tobacco—and have pricing power so they can pass higher costs fairly quickly—even daily—to consumers. Consumers can put off spending on fashion and tech gadgets, but need to buy soap, tissues and food staples and fill prescriptions, use the internet and keep the lights on even when the economy slows.

Also, over the past five to seven years corporations, including dividend-payers, have taken advantage of the low-rate environment to finance debt. They will continue to benefit from those low financing costs for some time to come. So we believe that solid, mature, long-time dividend-oriented companies will do just fine in a rising-rate environment.

Thank you, Debbie.

Q: What about prospects for international dividends? We have a positive outlook for 2018. One reason is the solid potential for global GDP growth. The International Monetary Fund has raised its GDP forecast again for this year. That's important because large, mature businesses that pay high dividends typically grow their companies and dividends more or less in line with the rate of GDP. Also, international markets have lagged the U.S. in a return to normal economic growth. This presents opportunity for U.S. investors in foreign equities.

Q: How about impacts from fluctuating currencies? When an overseas company declares a dividend, it is paid in that country's currency, which needs to be converted back to dollars for the U.S. investor. For the past several years, dividend payments in foreign currencies translated to lower effective dividend income growth for U.S. investors because of the comparatively strong U.S. dollar. This year we see the value of the Canadian dollar, British pound, Japanese yen and the euro increasing and converting into more U.S. dollars than they did a year ago. So it's presenting a nice tailwind for U.S. investors in international dividend-paying stocks.

Thank you, Jared

Deborah Bickerstaff
Portfolio Manager

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Gross Domestic Product (GDP) is a broad measure of the economy that measures the retail value of goods and services produced in a country.

International investing involves special risks including currency risk, increased volatility, political risks, and differences in auditing and other financial standards.

There are no guarantees that dividend-paying stocks will continue to pay dividends. In addition, dividend-paying stocks may not experience the same capital appreciation potential as non-dividend-paying stocks.

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