DIVIDENDS MATTER

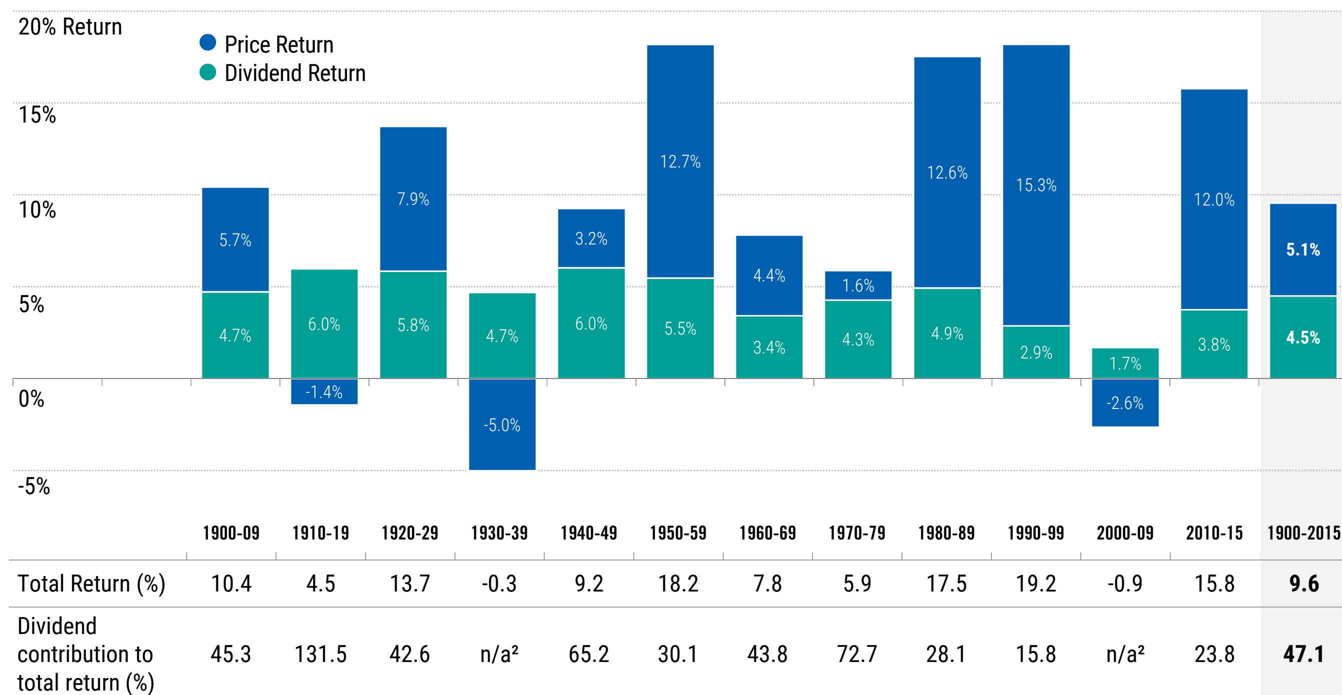
At Rational Advisors, we believe that dividends are a critical element in the pursuit of long-term equity returns. In this report, we discuss some characteristics of dividends in equity investing and offer views on the benefits of dividends in today's environment.

Historical Perspective

Throughout the majority of the 20th century, income generation was the primary focus for most equity investors. With accounting standards and regulatory oversight a far cry from where it is today, a stock's dividend was one of the few reliable measures by which investors could determine the health of public companies. While recent equity bull markets gave some credence to the notion that growth was perhaps superior to income, recent market declines should have reminded investors that a focus on both income and capital appreciation is a better approach to generating stable returns.

This premise is supported by the fact that over the long term, dividends have proven to be a meaningful source of stock-market returns. Since 1900 through the end of 2015, dividends have represented nearly half of the S&P 500 Index's total return[1]. **Figure 1** shows the contributions of dividends relative to price appreciation in each decade since 1900. While the contribution of dividends to total return has fluctuated, the contribution throughout time clearly demonstrates that dividends have played an important role in equity total return.

Figure 1 - Contributions of Dividends to Total Return
S&P 500 Index Annualized Return by Decade (1900-2015)[1]



	1900-09	1910-19	1920-29	1930-39	1940-49	1950-59	1960-69	1970-79	1980-89	1990-99	2000-09	2010-15	1900-2015
Total Return (%)	10.4	4.5	13.7	-0.3	9.2	18.2	7.8	5.9	17.5	19.2	-0.9	15.8	**9.6**
Dividend contribution to total return (%)	45.3	131.5	42.6	n/a[2]	65.2	30.1	43.8	72.7	28.1	15.8	n/a[2]	23.8	**47.1**

1.Data prior to 1988 is from "An Analysis of the S&P 500 Index and Cowles's Extensions: Price Indexes and Stock Returns, 1870–1999", Jack W. Wilson and Charles P. Jones, *The Journal of Business*, Vol. 75 No. 3 (July 2002) pp/ 505-533. Data after 1988 is sourced from Bloomberg and calculated by Rational Advisors. Total Return is annualized.

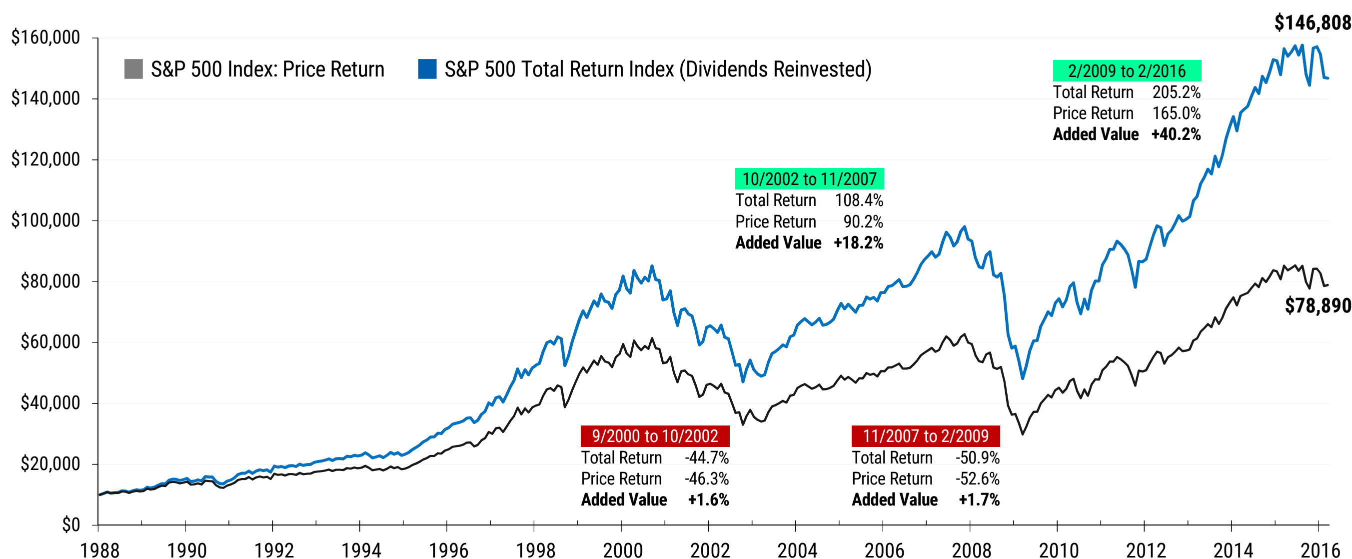
2. Because total return is negative, contribution from dividends to total return is not applicable.

Helping Weather Poor Markets

While many investors do not intuitively associate equity income with capital appreciation, dividends have proven to be a powerful element to building wealth, especially during periods of negative equity returns. Beyond the benefit of providing a 'cushion' in falling markets, dividends can also create an opportunity to accelerate and magnify a portfolio's recovery. Through the reinvestment of dividends, investors are able to capitalize on falling equity markets by accumulating additional shares at lower equity prices without the need to invest additional capital. This principle can have a powerful effect on long-term growth.

Figure 2 – Impact of Dividend Reinvestment on Long Term Growth

Hypothetical $10,000 Investment from January 1, 1988 through February 29, 2016



Source: Data is sourced from Bloomberg, results calculated by Rational Advisors.

For example, **Figure 2** demonstrates that from January 1988 through February 2016, a hypothetical $10,000 principal investment in the S&P 500 Index performed well on simply price appreciation, growing to $78,890, a 7.60% annualized return. However when dividends are continuously reinvested over the same period, the result is substantially higher cumulative growth to $146,808 or a 10.00% annualized rate of return.

As the chart illustrates, a large portion of this outperformance begins in 2000 through present during which time the S&P 500 experienced two significant declines. During these market declines, not only did dividends provide a slight cushion from losses, but the reinvestment of dividends enabled investors to accumulate additional shares at lower prices resulting in significantly accelerated returns during the subsequent periods of equity market recovery.

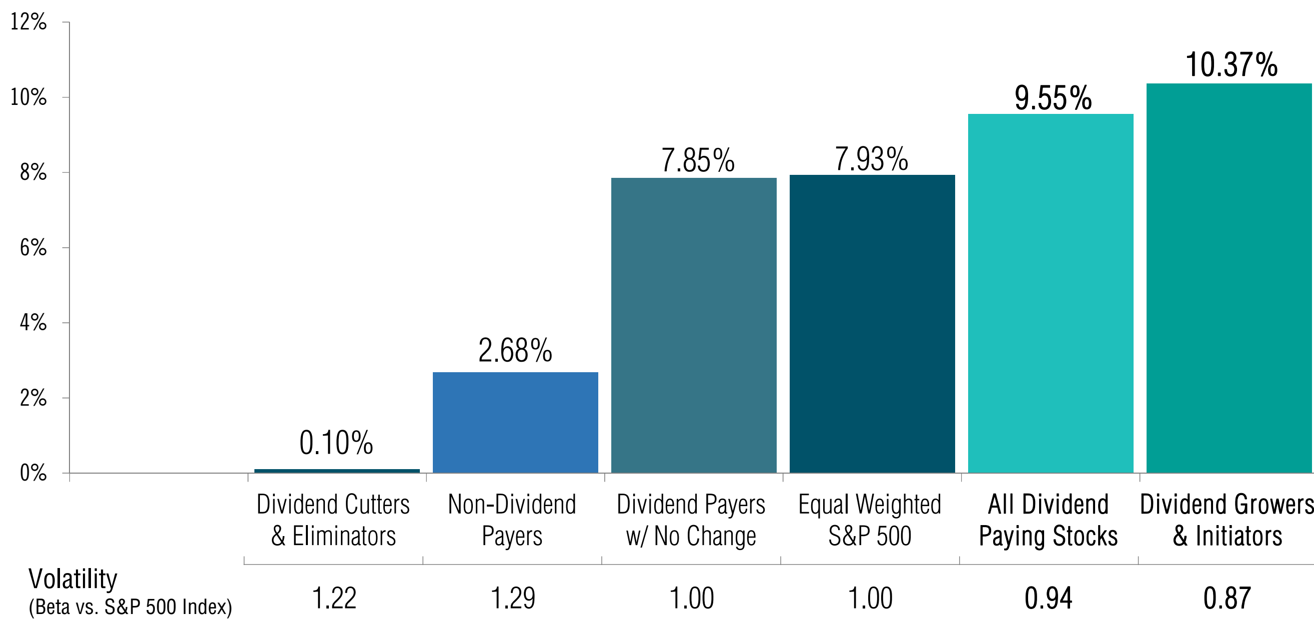
As demonstrated by the historical performance of the S&P 500 Index, an allocation to dividend paying stocks has played an important role in both outperforming over the long-term and minimizing downside during market declines.

Dividend Policies and Evaluating Corporate Health

Although today's investors have a surplus of quantitative and qualitative metrics at their disposal to evaluate stocks, dividend payments still remain a straightforward and effective tool to identify quality, well-run companies. A management team's commitment to distribute a portion of real earnings to its shareholders through dividends not only requires a disciplined and efficient approach to capital allocation, but it also signals to the market that management is confident in the current and future health of the company. Furthermore, unlike evaluating a company based on earnings or profits, which vary based on management accounting choices, dividends are paid to an investor in cash and not subject to estimation, manipulation or creative accounting.

Figure 3 illustrates the impact that various dividend policies have had on the stock performance of S&P 500 companies since 1972. As the chart shows, companies that have consistently grown or initiated a dividend have delivered the strongest historical returns, while companies that cut or eliminated their dividend were the worst performers.

Figure 3 – Total Returns & Volatility of S&P Stocks by Dividend Policy
Average Annual Returns, Beta vs. S&P 500 (January 1972 to December 2014)



Source: 2015 Ned Davis Research, Inc. *Dividend Growers & Initiators* represents all dividend-paying stocks that raised their existing dividend or initiated a new dividend; *All Dividend Paying Stocks* represents all dividend-paying stocks; *Dividend Payers w/ No Change* represents all dividend-paying stocks that have maintained their existing dividend; *Non-Dividend Payers* represents non-dividend paying stocks; and *Dividend Cutters & Eliminators* represents stocks that have lowered or eliminated their dividend.

Summary Points

- Since 1900, dividends have represented a significant portion of the S&P 500 Index's total return.
- Dividends not only provide a valuable cushion against falling markets but also enable investors to position their portfolios for stronger performance over the long term as markets recover.
- Dividend payments still remain a straightforward and effective tool to identify quality, well-run companies.

rationaladvisors
36 North New York Avenue
Huntington, NY 11743

Email: info@rationalmf.com
Phone: 1-800-253-0412

4331-NLD-5/6/2016

The views expressed in the material are those of the author as of March 2016 and are subject to change based on market conditions and other facts. These views should not be construed as a recommendation for any specific security.

The S&P 500 Index is an unmanaged index generally representing the performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries. Indices are unmanaged and, unlike funds, are not affected by cash flows. It is not possible to invest directly in an index.

Past performance is not a guarantee of future results.

Investing involves risk, including loss of principal. 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.

Investors should carefully consider the investment objectives, risks, charges and expenses of the Rational Funds. This and other information about the Funds is contained in the prospectus, which can be obtained by calling (800) 253-0412 or on this website. The prospectus should be read carefully before investing. The Rational Funds are distributed by Northern Lights Distributors, LLC member FINRA/SIPC. Rational Advisors, Inc. is not affiliated with Northern Lights Distributors, LLC.