

Dividend Strategy with Quality Yields – The Dow Jones U.S. Dividend 100 Index

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Dividend-paying stocks have been in focus in recent years—many income seekers have turned away from low-yielding fixed income instruments and are looking to equity markets for an attractive level of income. After the rise of interest rates at the end of 2018, a continuing search for yield is expected. However, this search for yield will probably be guided by a focus on quality, and it likely will be against a backdrop of future rising rates.

Among different kinds of income-focused equity indices in the market, the [Dow Jones U.S. Dividend 100 Index](#) takes a unique approach. The index not only seeks to track stocks with consistent dividend payouts, but it also applies quality assurance for the sustainability of yields. It seeks to achieve “quality yields” by requiring stocks to have paid dividends for a minimum of 10 consecutive years, and by ranking stocks by a composite score calculated from the cash-flow-to-total-debt ratio, return on equity (ROE), dividend yield, and five-year dividend growth rate.

A focus on dividend growth in an environment where market participants are concerned about rising rates is important. Typically, high-yield equity strategies are biased toward rate-sensitive sectors, which pay out high yields because of the leverage that they can take on (mainly because of mature business models, e.g., utilities). Such entities are exposed when rates rise. Selection based on dividend growth ensures that firms that can develop their business and increase their payouts are favored in the selection process. Such businesses often tend to be well-managed companies, from both capital structure and operational perspectives.

Also differentiating the Dow Jones U.S. Dividend 100 Index from other dividend strategies are its strict size and liquidity screens and its weighting method, which is based on a modified market capitalization approach. These attributes aim to increase tradability, reduce the influence of smaller and more-distressed stocks on the portfolio, and attain a certain degree of diversification by capping sector- and stock-level exposures at 25% and 4.5%, respectively. A weighting method based on modified market capitalization also has the potential to lead to a lower turnover than alternatively weighted income indices that primarily weight based on yield or total dividends.

Exhibit 1 summarizes the construction methodology and the ideas behind the Dow Jones U.S. Dividend 100 Index, which seeks to balance yield, quality, capacity, and diversification.

Not only does the Dow Jones U.S. Dividend 100 Index seek to track stocks with consistent dividend payouts, but it also applies quality assurance for the sustainability of yields.

Exhibit 1: Construction Methodology for the Dow Jones U.S. Dividend 100 Index	
INDEX METHODOLOGY	TARGETS INTENDED TO ACHIEVE
Screens for dividend payment consistency, size, and liquidity. <ul style="list-style-type: none"> • Minimum 10 consecutive years of dividend payments. • Minimum float-adjusted market capitalization of USD 500 million. • Minimum three-month average daily trading volume of USD 2 million. 	A prerequisite of tradability by screening for a stock's capacity and liquidity. A requirement of consistent dividends by screening for stocks that have paid dividends for a minimum of 10 consecutive years.
Stocks that pass the screens are ranked in descending order by indicated annual dividend yield. The top half is eligible for selection.	A focus on absolute yield by owning the highest-yielding stocks that pass the size, liquidity, and dividend payment consistency screens.
Stocks are then ranked by a composite score of cash-flow-to-total-debt, ROE, dividend yield, and five-year dividend growth rate. The top 100 are selected as constituents.	An emphasis on the quality factor, which is relevant when considering a company's ability to generate free cash flow so that a dividend can be sustained and, potentially, increased.
Stocks are weighted by market capitalization, and they are subject to a 4.5% individual stock weight cap and a 25% sector weight cap.	An attention to representativeness by using a modified market cap weighting so that distressed smaller-cap firms don't dominate its portfolio.
Annual rebalance in March.	A key element for reducing turnover.

Source: S&P Dow Jones Indices LLC. Table is provided for illustrative purposes.

The constituents of the Dow Jones U.S. Dividend 100 Index have delivered better yields and better capital gains over the long term when compared with its benchmark.

The two things that market participants tend to care most about when using any income strategy are yield and capital gain. The constituents of the Dow Jones U.S. Dividend 100 Index have delivered both better yields and better capital gains over the long term when compared with the constituents of its benchmark, the [Dow Jones U.S. Broad Stock Market Index](#). For the period between March 31, 1999, and March 29, 2019, the price return of the Dow Jones U.S. Dividend 100 Index was 7.0% per year, outperforming its benchmark's 4.6%. The total return of the index, which assumes theoretical reinvestment of dividends, was 10.6% per year, outperforming the 6.5% total return of the benchmark (see Exhibit 2).¹

The difference between the total return and the price return is represented by the dividend paid out, although the effect is a bit magnified due to capital appreciation of the theoretical reinvested dividend portion. For the Dow Jones U.S. Dividend 100 Index and the Dow Jones U.S. Broad Stock Market Index, the difference is 3.69% and 1.90%, respectively. The Dow Jones U.S. Dividend 100 Index has had a better yield over time, indicating that the strategy has identified and weighted the companies that maintained or increased their dividend payouts. Besides that, the strategy has held on to its constituents long enough so the yields have been hypothetically received, rather than only seen on paper.

¹ Note that the Dow Jones U.S. Dividend 100 Index was launched on Aug. 31, 2011. The foregoing information is based on back-tested data.

Exhibit 2: Risk/Return Profiles				
ANNUAL RETURN (%)	DOW JONES U.S. DIVIDEND 100 INDEX		DOW JONES U.S. BROAD STOCK MARKET INDEX	
	TOTAL RETURN	PRICE RETURN	TOTAL RETURN	PRICE RETURN
3-Year	12.56	9.00	13.45	11.28
5-Year	10.49	7.01	10.33	8.21
7-Year	12.71	9.20	12.59	10.39
10-Year	16.56	12.86	16.01	13.75
15-Year	10.93	7.34	8.82	6.73
20-Year	10.64	6.95	6.54	4.64
ANNUAL VOLATILITY (%)				
3-Year	10.43	10.36	11.11	11.08
5-Year	10.59	10.53	11.51	11.48
7-Year	10.29	10.27	11.11	11.09
10-Year	11.57	11.56	13.13	13.12
15-Year	12.64	12.65	14.04	14.04
20-Year	13.49	3.48	14.92	14.90
RISK-ADJUSTED RETURN				
3-Year	1.20	0.87	1.21	1.02
5-Year	0.99	0.67	0.90	0.71
7-Year	1.24	0.90	1.13	0.94
10-Year	1.43	1.11	1.22	1.05
15-Year	0.86	0.58	0.63	0.48
20-Year	0.79	0.52	0.44	0.31
MAXIMUM DRAWDOWN (%)				
20-Year	-44.47	-47.44	-50.84	-52.34

The Dow Jones U.S. Dividend 100 Index shows reduced risk, as measured by volatility and drawdown.

The Dow Jones U.S. Dividend 100 Index's focus on quality of dividend payers and dividend growth has resulted in a fairly uniform distribution of names across sectors over time.

Source: S&P Dow Jones Indices LLC. Data as of March 29, 2019. Past performance is no guarantee of future results. Table is provided for illustrative purposes and reflects hypothetical historical performance. Please see the Performance Disclosure at the end of this document for more information regarding the inherent limitations associated with back-tested performance.

The back-tested data in Exhibit 2 show that the Dow Jones U.S. Dividend 100 Index's total returns outperformed the benchmark over the past 5, 7, 10, 15, and 20 years. For the three-year period, however, it was not able to outperform the benchmark. The Dow Jones U.S. Dividend 100 Index showed reduced risk, as measured by volatility and drawdown. As a result, the historical outperformance may be considered higher in terms of risk-adjusted returns. For the period between March 31, 1999, and March 29, 2019, the risk-adjusted return (the ratio of annual return to annual volatility) of the index was 0.79, which was almost double that of the benchmark. We believe this effect may come from the defensive nature of the income strategy and the quality tilts that are uniquely carried by the Dow Jones U.S. Dividend 100 Index.

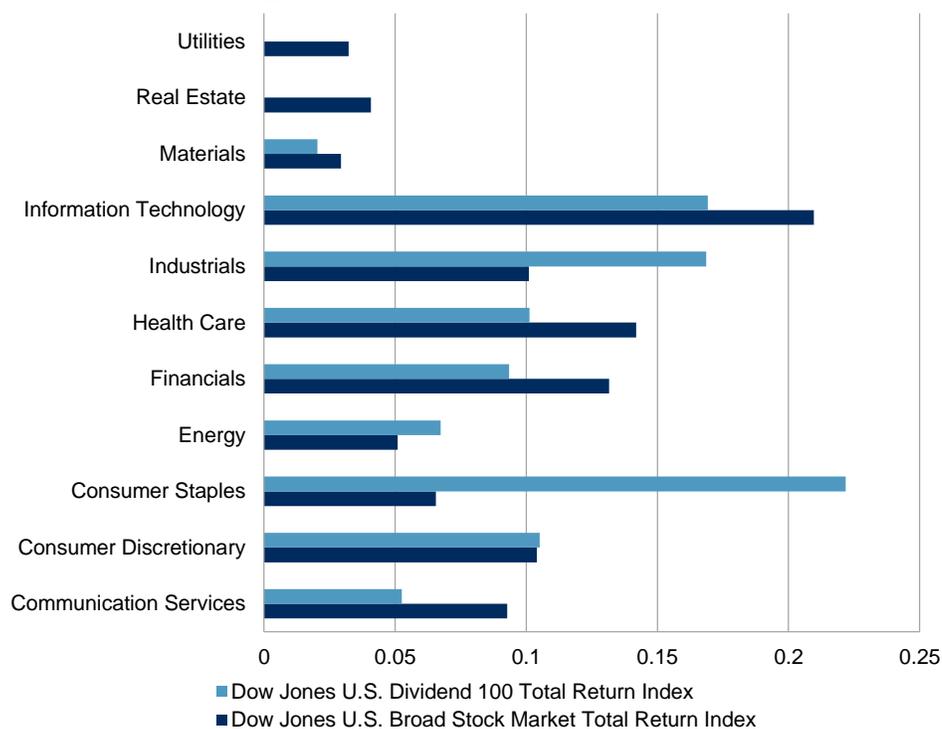
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As noted earlier, the turnover for the Dow Jones U.S. Dividend 100 Index over the 10-year period was 25% annually on average, which is a fairly moderate rate (see Exhibit 3).

Exhibit 3: Index Characteristics		
INDEX FUNDAMENTALS	DOW JONES U.S. DIVIDEND 100 INDEX	DOW JONES U.S. BROAD STOCK MARKET INDEX
Dividend Yield (%)	3.20	1.85
ROE Trailing	0.23	0.14
Number of Constituents	100	2496
CONSTITUENT MARKET CAP (USD MILLIONS)		
Mean Total Market Cap	38,119.05	12,097.91
Largest Total Market Cap	342,349.60	904,860.80
Smallest Total Market Cap	542.33	24.47
Median Total Market Cap	12,589.26	2,301.59
COMPONENT WEIGHT (%)		
Weight Largest Constituents (%)	4.70	3.20
Weight Top 10 Constituents (%)	45.20	17.80
TURNOVER RATE (%)		
Turnover Rate at March 2016 Rebalancing	30.61	0.35
Turnover Rate at March 2017 Rebalancing	17.19	0.45

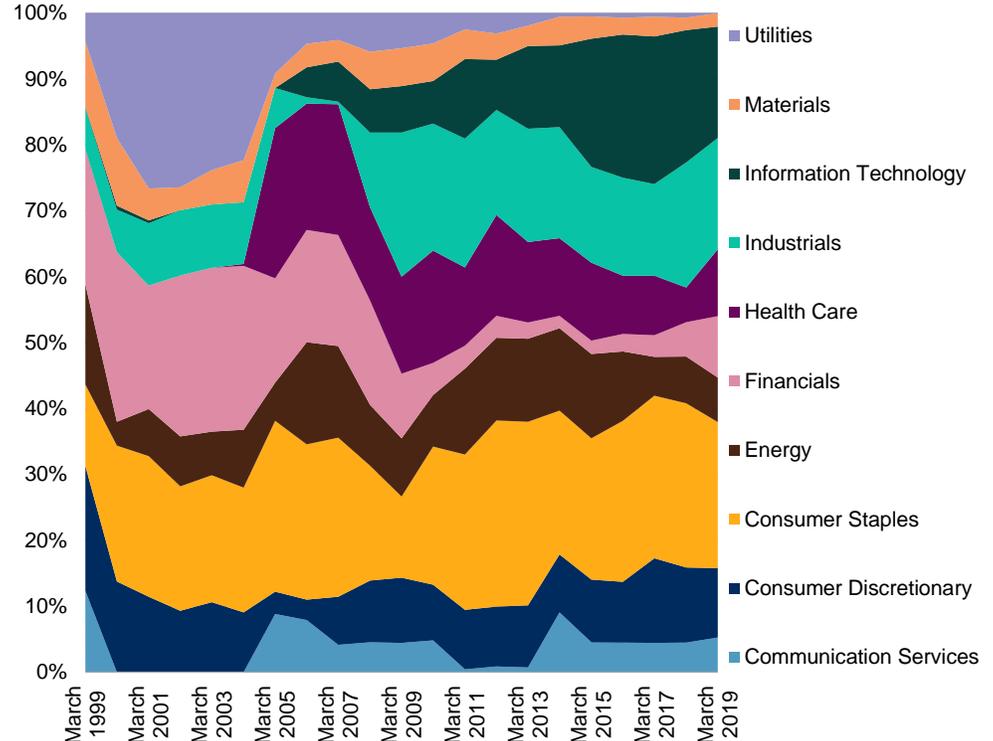
Source: S&P Dow Jones Indices LLC. Data as of March 29, 2019. Table is provided for illustrative purposes. Past performance is no guarantee of future results.

Exhibit 4: Sector Weights



Source: S&P Dow Jones Indices LLC. Data as of March 29, 2019. Chart is provided for illustrative purposes.

Exhibit 5: Historical Sector Weights of the Dow Jones U.S. Dividend 100 Index



Source: S&P Dow Jones Indices LLC. Data from March 31, 1999, to March 29, 2019. Chart is provided for illustrative purposes.

Exhibit 6: Historical Annual Turnover of the Dow Jones U.S. Dividend 100 Index

YEAR	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Turnover (%)	26.7	27.0	31.0	20.9	15.7	25.0	15.8	23.3	15.4	37.7

Source: S&P Dow Jones Indices LLC. Data as of March 29, 2019. Table is provided for illustrative purposes.

The Dow Jones U.S. Dividend 100 Index is designed to measure dividend payers in the U.S. market by focusing on quality and dividend growth.

The Dow Jones U.S. Dividend 100 Index is designed to measure dividend payers in the U.S. market by focusing on quality and dividend growth. These characteristics are important in an environment where interest rates are on the move and are expected to continue upward. The modified market capitalization weighting approach used by the index also provides the index with a higher capacity and reduced turnover rate when compared with other alternatively weighted strategies.

PERFORMANCE DISCLOSURE

The Dow Jones U.S. Dividend 100 Index was launched on August 31, 2011. The Dow Jones U.S. Broad Stock Market Index was launched Feb. 28, 2005. All information presented prior to an index's Launch Date is hypothetical (back-tested), not actual performance. The back-test calculations are based on the same methodology that was in effect on the index Launch Date. Complete index methodology details are available at www.spdji.com.

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