Market Commentary Blog

Cash Flow *and Carey*

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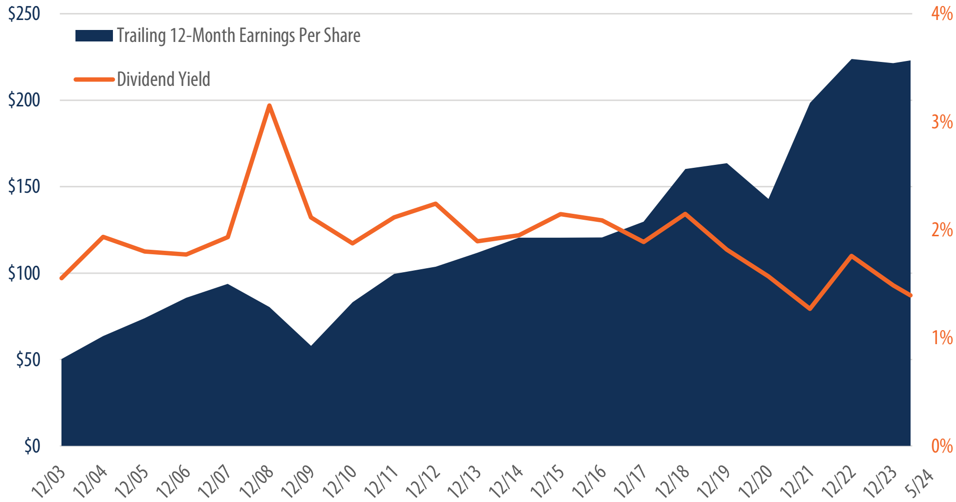
Plenty Of Room For Dividend Growth

S&P 500 Index Earnings vs. Yield



Source: Bloomberg. Annual data points from 12/31/2003 – 5/3/24. **Past performance is no guarantee of future results.**

View from the Observation Deck

Dividend payments have been a key characteristic of most of the companies that comprise the S&P 500 Index ("Index") for decades. As of 4/30/24, 404 of the 503 companies that comprise the Index paid a dividend. That figure is little changed from 1998, when 418 companies in the Index paid dividend distributions to shareholders. For today's discussion, we set out to explain the fundamental relationship between dividends and earnings, and to determine if the recent record-high earnings in the Index have translated into higher yields.

The companies that comprise the Index distributed a record $588.2 billion in dividends in 2023, up 4.2% from $564.6 billion in 2022. Despite record distributions, the dividend yield of the S&P 500 Index has been trending downward (see chart).

Companies will often increase their dividend distributions just enough to keep yields from falling as valuations increase. Over the 10-year period between 12/31/09 and 12/31/19, the Index posted an average annual total return of 13.54%. The Index's yield fluctuated between 1.76% and 2.41% (2.01% on average) over the time frame. For comparison, the yield on the Index averaged 1.95% over the full period captured in today's chart.

As of 5/3/24, the yield on the Index stood at just 1.39%.

As of 5/3/24, full-year earnings estimates for the Index were forecast to reach record levels of $244.67 and $277.47 in 2024 and 2025, respectively.

Given that dividends are paid from profits, a company's ability to grow its earnings plays a crucial role in assessing its capacity to maintain (or grow) its dividend payout. From our perspective, the consistent, long-term pattern of earnings growth revealed in today's chart, combined with the recent decline in the Index's yield, could be a signal that the environment is ripe for dividend growth.

The S&P 500 Index's dividend payout ratio is currently well-below average.

As many investors are likely aware, the dividend payout ratio measures the percentage of earnings that are paid to shareholders in the form of dividends. The Index's dividend payout ratio stood at just 35.65% on 4/30/24. For context, the Index's dividend payout ratio averaged 41.90% over the period captured in today's chart.

Takeaway

Dividends have played an indispensable role in equity valuations for many decades. As noted above, the combination of low current yields, record-high earnings, and a below-average dividend payout ratio may be an indication that conditions are conducive to near-term dividend growth for the Index. That said, companies will be watching closely for evidence of an economic slowdown. Should weakness manifest, we expect they will likely hoard their cash rather than distribute it back to shareholders.