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GLOBAL INVESTMENTS

DIVIDENDS:
A SIGNIFICANT DRIVER OF TOTAL RETURN

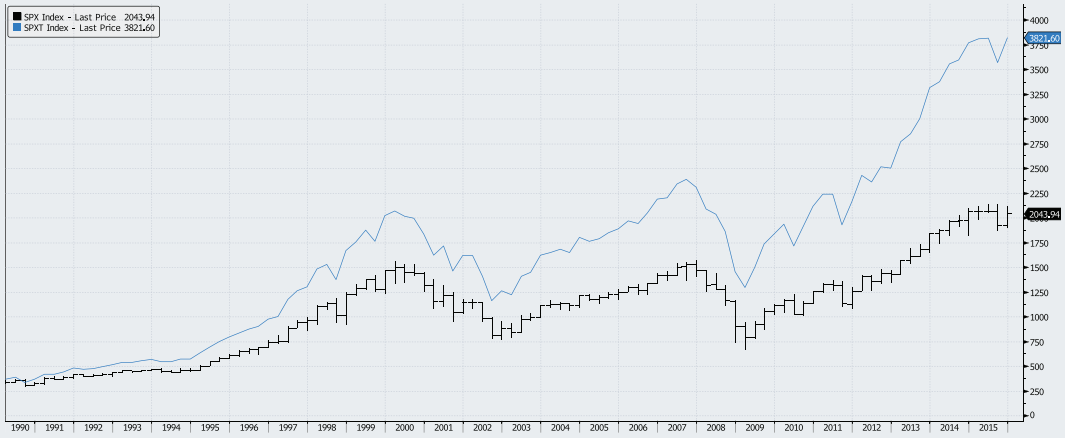
- Investors seemingly turn more and more to dividend paying equities to achieve their income objectives.
- Dividends are a significant driver of total return for the S&P 500.
- The quest for higher yield can lead to unintended sector risk.
- A strategy that allows for a global allocation has more flexibility to build a diversified dividend portfolio than a domestic-only portfolio.

The vast universe of dividend investment strategies existed long before the Federal Reserve created a low interest rate environment. Now, yield starved investors seemingly turn more and more to dividend paying equities to achieve their income objectives. While dividend strategies will fall in and out of vogue like every other investment vehicle, they will continue as a relevant investment strategy as many investors state dividend payouts as one of the most important factors when considering an investment decision. This viewpoint contributes to the long-term demand for dividend stocks. As it turns out, there may be a reason for the longevity of demand for dividend strategies: Dividends are a significant driver of total return for the S&P 500.

The Impact of Dividends on the S&P 500

Since 1956, dividends have represented about one-third of the S&P 500 total return. Price appreciation accounts for the other two-thirds of the performance.[1] The graph below illustrates the power of compounding. One line shows S&P 500 price returns and one line which shows dividends reinvested into the S&P 500. While dividends significantly contribute to total return, reinvesting dividends has the power to unlock the compounding effect.

S&P 500 Price Return v. Dividends Reinvested: 1955 through May 2016



Source: Bloomberg

There are other reasons that make dividend strategies important to investors' portfolios. According to S&P Global Research Group, dividends accounted for 5.89% of personal income in the United States in 2014 versus 2.85% in 1981. Conversely, the proportion of interest as a source of income fell from 13.5% to 8.6% during the same period of time.[2] Furthermore, higher dividend paying stocks achieved historical outperformance of the broader market during the down markets between 1970 and 2007.[3] These factors also contribute to the ubiquity of dividend strategies as a portion of many investors overall allocation.

[1] S&P Global Strategy 101. The Importance of Dividends. October 2015 at p. 1 & Bloomberg data.

[2] Id.

[3] See Generally Goldstein, Michael A. "Do dividends matter more in declining markets?." Journal of Corporate Finance (2011).

Not All Dividend Strategies are Created Equal

There are some important facets of dividend strategies that require consideration when choosing a specific strategy. Consider that there are a myriad of strategies that attempt to achieve the same goal: high yield. This makes the methodology of the strategies important, because some strategies achieve higher yield by taking certain risks dividend investors may not want within the allocation. If the goal is to find a dividend paying strategy, then a strategy that controls for other risks may make more logical sense than a strategy that places other bets. Here are some factors to consider with dividend strategies:

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1. **Sector Allocation** – Does the dividend paying strategy attempt to more closely match the sector allocation of a diversified stock index, or does it significantly overweight sectors in search of yield? If a strategy overweights sectors to achieve yield, the returns of this strategy may be more sensitive to sector weight than dividends.

2. **Geographic Diversity** – Is the strategy limited to one geography or can it purchase securities domiciled in multiple countries? Relative valuations and yields constantly change over time. Sometimes, the best place to find relatively cheap dividend paying equities is the U.S. market. Other times, companies domiciled abroad provide the best risk-adjusted yield, even after tax considerations. All else equal, a strategy that allows for a global allocation has more flexibility to build a diversified dividend portfolio than a domestic-only portfolio.

3. **Dividend Growth Rate** – Does the strategy achieve the highest possible yield by purchasing equities that most closely resemble the characteristics of a bond or does it weigh the dividend growth rate? Some strategies target the highest possible yield without regard to concentration risk. These strategies end up with a portfolio of equities best described as "bond proxies." A more general equity risk based dividend strategy measures its yield as a multiple of the underlying index and moves within this range. Furthermore, a more balanced strategies focuses on growing dividends, like the three year dividend growth rate, as an investment factor.

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Overall, dividend strategies are an important investment strategy for any investor to consider. Dividends drive a significant piece of total return, are relied upon more and more for income, historically perform better in down markets, and can unlock the power of compounding when reinvested. Given that the population distribution of the U.S. is aging and income from traditional sources is difficult to find, it seems that there will be a steady demand for dividend paying stocks in the future. In this context, it would not be surprising to see diversified dividend strategies continue to grow assets over the long-term.

About Crossmark's 30 Year History

Crossmark, previously Capstone Asset Management Company, is an independent investment advisor headquartered in Houston, Texas. Founded in 1987, Crossmark is in its 30th year of providing portfolio solutions for financial advisors and institutional investors with values-based, SRI and ESG values and factor-based strategies. Additionally, Crossmark is the exclusive manager of the Crossmark Steward Funds, which is a fund family that applies an overarching values-based screening methodology to its suite of equity and fixed income funds, including its award-winning Global Equity Income Fund- named Lipper's "Best Global Equity Income Fund" for the last three consecutive years. Crossmark manages approximately $5 billion in assets with clients nationwide.

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