

ESG Lens Enhances Pursuit of Equity Income

December 9, 2020

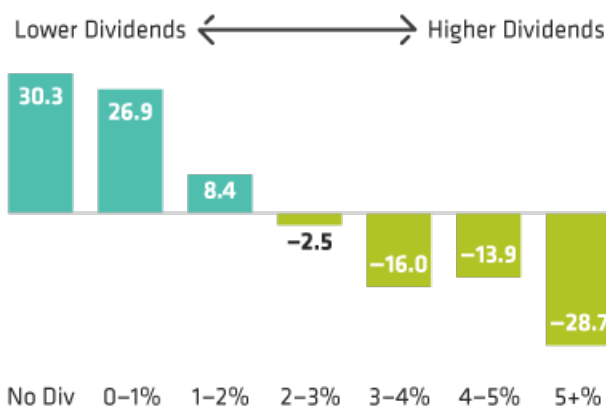
by Cem Inal
of AllianceBernstein

How Investors Can Better Identify High-Dividend Stocks with Return Potential

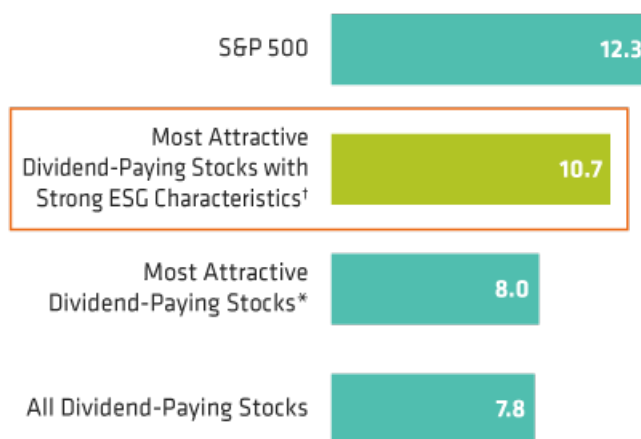
High-dividend stocks haven't been rewarded in 2020

But an ESG focus can help identify high-dividend winners over time

US Stocks: Returns by Dividend Yield (Percent)
Jan–Oct 2020



US Stocks: Annualized Returns (Percent)
Jan 2016–Oct 2020



Past performance and current forecasts do not guarantee future results.

As of October 31, 2020

*Most attractive tercile of dividend-paying stocks using AllianceBernstein's proprietary quantitative tools focusing on valuation, sustainability, risk, and payout

†Stocks meeting the following criteria: Most attractive tercile of dividend-paying stocks using AllianceBernstein's proprietary quantitative tools and top tercile of MSCI ESG scores

Source: Bloomberg, S&P and AllianceBernstein (AB)

Income-seeking investors have been frustrated in recent years as US dividend-paying stocks underperformed. But companies that offer strong payouts in a sustainable manner can help investors source surprisingly robust streams of income and equity returns.

During 2020, shares of US companies that pay no dividends returned 30.3%, while those with high dividends have fallen by at least 16% (*Display, left*). Poor performance for dividend stocks this year caps a lackluster five-year period. Since 2016, dividend-paying stocks returned an annualized average 7.8% per year, trailing the S&P 500 by 4.5 percentage points (*Display, right*). The most attractive dividend-paying stocks have done better but still lagged the market. Yet since 1971, the two highest-yielding quintiles of US stocks have returned more than 14.5% on an annualized basis, exceeding returns for the broader market at lower levels of volatility.

Pandemic Shakes Reliability of Dividends

So why are dividend payers out of favor in 2020? Companies that pay little or no dividends dominated US returns this year, as investors flocked to high-sales-growth companies with business models that have been supported by consumer trends during the lockdowns. And with many companies cutting dividends under COVID-19 pressure, high payouts simply aren't seen as reliable sources of income these days.

But not all dividends are equally vulnerable. Our research shows that among the most attractive group of dividend-paying stocks, those with strong environmental, social and governance (ESG) features tend to perform much better than the rest.

Since 2016, these stocks returned 10.7% per year, about 2.9 percentage points higher than other dividend-paying stocks.

Good Corporate Behavior Supports Sustainable Cash Flows

Robust ESG practices can help support sustainable businesses. In turn, these practices can help ensure that companies are generating the stable cash flows needed to support dividend payouts and returns.

Finding these companies requires a research approach that integrates ESG issues into fundamental business analysis. First, look for companies with sustainable and rising cash flows, supported by positive business dynamics. Then, based on research of the company's business, use an ESG lens to identify factors that can help forecast the persistence of those cash flows more effectively.

Standard ESG ratings aren't enough, as they may be backward looking and don't always capture companies' improvement potential. By studying a company with an eye on ESG issues that could materially improve its outlook, or add unwanted risks on the downside, we believe investors can identify exceptional equity-income candidates. And with valuations of high-dividend-yield stocks versus the broader market lower than they've been in the last two decades, we think a research-driven ESG-focused approach to dividend stocks can unlock strong recovery potential for income investors.

Cem Inal is Co-Chief Investment Officer for US Large-Cap Equities and Portfolio Manager for US Equity Income at AllianceBernstein (AB)

The views expressed herein do not constitute research, investment advice or trade recommendations and do not necessarily represent the views of all AB portfolio-management teams and are subject to revision over time.