Inflation, Interest Rates and Dividends

ADVISORS ASSET MANAGEMENT

With inflation now at levels not seen in roughly 40 years, coupled with expectations that it may not be as transitory as once thought (particularly given the likely impact Russian sanctions could have on energy prices), we thought it would be useful to see how inflation and rising rates have historically impacted equity returns by dividend policy.

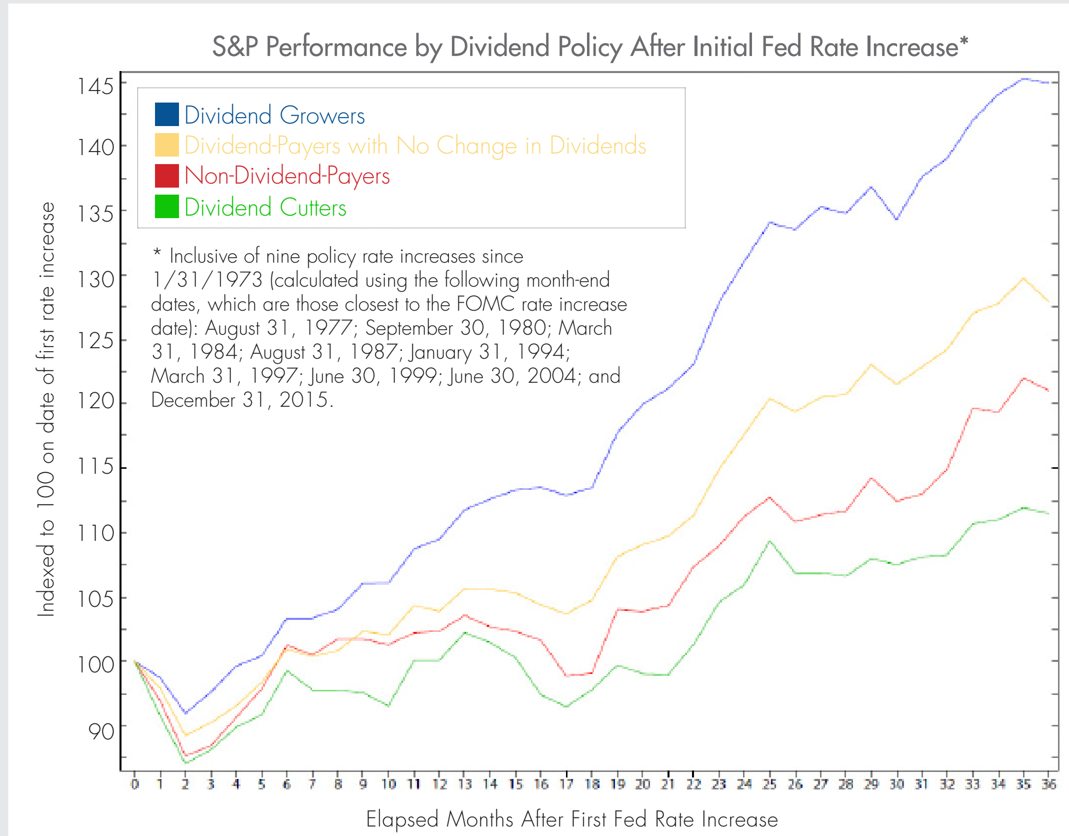
In general, when inflation increases, input costs rise and earnings/ profits can decline, thereby compressing multiples (a generic term for a variety of ratios often used to value a stock) – an indication that stock prices have the potential to decline.

But this doesn't necessarily have to apply to all companies. In fact, companies with differentiated business models (defensible barriers and pricing power) tend to be able to pass rising input costs to the consumer and possibly preserve profitability, or earnings. Therefore, amid inflation, we would expect companies with more pricing power and lower multiples to be less vulnerable to compression than their counterparts with less pricing power and higher multiples.

Today, many dividend-paying equities carry lower multiples than their non-dividend-paying counterparts, indicating that these stocks may have a greater chance of weathering inflationary pressures and higher interest rates.

Inflation and rising rates often go hand-in-hand as the Federal Reserve (Fed) normally raises rates to address inflation. We therefore thought it would be useful to look at the performance of the S&P 500 Index constituents broken down by dividend policy for the 36 months following initial Fed rate increases.

While all cohorts declined initially, all were higher at the end of the three years following interest rate liftoff. Dividend Growers (blue line) declined the least initially and were the top performers throughout the period, followed by Dividend-Payers with no change in dividends, then non-dividend companies and last, dividend cutters.



 It is not possible to invest directly in an index. **Past performance does not guarantee future results.** Returns are not indicative of the performance of any AAM product. The returns do not reflect the deduction of any fees, expenses or taxes. Returns for stocks that paid dividends assume reinvestment of all income. Returns based on monthly equal-weighted geometric average of total returns of S&P 500 component stocks, with components reconstituted monthly.

The S&P 500 Index is an unmanaged market capitalization-weighted index used to measure 500 companies chosen for market size, liquidity and industry grouping, among other factors. See reverse for index descriptions and additional important information.

Bottom line, we believe dividend-paying equities in general, and dividend growing equities in particular, could be beneficial to a portfolio's overall return, particularly during inflationary periods.

In fact, we believe companies that grow their dividend may be best-suited to weather today's environment.

Contact a financial professional to discuss the potential benefits and risks that dividend-paying equities may have on your portfolio in today's environment.

Dividend Payment Risk: An issuer of a security may be unwilling or unable to pay income on a security. Common stocks do not assure dividend payments and are paid only when declared by an issuer's board of directors. The amount of any dividend may vary over time. **Market volatility.** A company's stock price, whether dividend-paying or not, may move up or down depending on various market conditions. Therefore, the initial principal invested may be worth less when an investor decides to sell, depending on the market value of the underlying holding. **Loss of income.** A company may choose to skip or suspend dividend payments. In this case, shareholders lose the investment income and might also see the value of their shares fall if income-oriented investors sell their holdings. **Underperformance.** During market rallies, dividend stocks historically lag the broader market, causing investors to accept relatively lower return potential in exchange for less volatility and income. **Increase in income tax rates**. The current dividend tax rate is subject to legislative changes. Please consult a tax professional regarding the taxation of dividends.

Definitions: Inflation is measured by the **Consumer Price Index (CPI)**, which is a statistic released by the Bureau of Labor Statistics as a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. **Dividend-Paying vs. Non-Dividend-Paying Stocks:** Each stock's dividend policy is determined by its indicated annual dividend. Ned Davis Research classifies a stock as a dividend-paying stock if the company indicates that it is going to be paying a dividend within the year. A stock is classified as a non-payer if the stock's indicated annual dividend is zero.

The index returns are calculated using monthly equal-weighted geometric averages of the total returns of all dividend-paying (or non-paying) stocks. A stock's return is only included during the period it is a component of the S&P 500 Index. The dividend figure used to categorize the stock is the company's indicated annual dividend, which may be different from the actual dividends paid in a particular month.

Dividend-Growing, No-Change-In-Dividend, and Dividend-Cutting: Dividend Growers include stocks that increased their dividend anytime in the last 12 months. Once an increase occurs, it remains classified as a Grower for 12 months or until another change in dividend policy. No-Change stocks are those that maintained their existing indicated annual dividend for the last 12 months (i.e., companies that have a static, non-zero dividend). Dividend Cutters are companies that have lowered or eliminated their dividend anytime in the last 12 months. Once a decrease occurs, it remains classified as a Cutter for 12 months or until another change in dividend policy.

It is not possible to invest directly in an index.

This publication is provided for informational purposes only and does not pertain to any security or service and is not an offer or solicitation of an offer to sell any product or service. Unless otherwise stated, all information and opinions contained in this publication were produced by Advisors Asset Management, Inc. (AAM) and other sources believed by AAM to be accurate and reliable. Due to rapidly changing market conditions and the complexity of investment decisions, supplemental information and other sources may be required to make informed investment decisions based on your individual investment objectives and best interests. All expressions of opinions are subject to change without notice. All AAM employees, including research associates, receive compensation that is based in part upon the overall performance of the firm. AAM may make a market in or have other financial interests in any given sector with which this analysis suggests may be benefited from its conclusions. Investors should seek financial guidance regarding the appropriateness of investing in any security or strategy discussed in this report and should understand that statements regarding future prospects may not be realized. **Past performance does not guarantee future performance.** Nothing contained herein constitutes investment, legal, tax or other advice. This should not be construed as a solicitation.