Investing in Dividends for Growth

Monday 16 February, 2015

- **High yield stocks have doubled the return of low yield stocks over 20 years**
- **This applies across large cap, mid cap and small cap stocks**
- **The FTSE 100 index at a record high**
- **Why high yield stocks have prospered**
- **Income funds for long term growth**

Global dividends hit a record high of $1.2 trillion in 2014, according to the Henderson Global Dividend Index, released today.

Dividend paying stocks are naturally popular with income-seeking investors, but our analysis shows they should be prized by growth investors too.

Meanwhile on Friday 13th February, the FTSE 100 reached a record high, if you take account of the dividends paid by the big blue chip firms.

Laith Khalaf, Senior Analyst, Hargreaves Lansdown:

'Growth investors shouldn't fall into the trap of thinking income funds are just a boring investment used by pensioners to boost their income. As we know the tortoise beats the hare in a foot-race, and likewise one of the best routes to long term growth is through harvesting dividends and re-investing them.

Equity income funds do just that, often with lower volatility than the rest of the market. These funds should be considered by even the youngest investors in Junior ISAs and SIPPs as a building block for future growth, as well as retired savers looking for extra income from their investments.'

High yield stocks outperform low yield stocks

High yield UK stocks have more than doubled the return of their low yield counterparts over the last 20 years. This is irrespective of the size of the company, as can be seen from the table below, which shows the return from the highest and lowest yielding stocks in the UK market.

There are times when low yield stocks have streaked ahead of high yield stocks- during the tech boom for instance, but these figures suggest that over time the tortoise-like dividend payers ultimately overtake the hares.

FTSE 100 hits record high

The FTSE 100 total return index hit a record high on Friday, closing at 5,204.

If you're kicking yourself for missing it, don't worry- everyone is. That's because the headline FTSE 100 Index we all regularly obsess over still stands below its December 1999 peak.

But once you include the dividends paid by FTSE 100 stocks, as of Friday 13th, the total return index is 66% above its December 1999 level. This index has regularly reached record highs, indeed the previous high was achieved only two weeks ago.

This illustrates how important dividends are to stock market returns.

Laith Khalaf, Senior Analyst, Hargreaves Lansdown:

'It's the FTSE Jim, but not as we know it. The main FTSE 100 index has unquestionably become the barometer of the UK stock market, but it misses one vital component- dividends. The importance of dividends should not be underestimated, and an index which includes them better portrays the fortunes of the UK stock market investor.

Fortunately FTSE also publish a total return version of the 100 index, which is largely ignored on a day to day basis. With dividends included, this index stands over 60% ahead of is December 1999 level, when the main price index hit an all-time high. This tells us in a nutshell what a huge difference re-invested dividends can have on a portfolio.'

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Why do high yield stocks do better?

There are a number of explanations for the outperformance of high yielders.

- The simplest explanation is the power of compounded dividends. Even if you take a 3% dividend yield and reinvest it each year, you end up doubling your money in 23 years, before even factoring in any capital or dividend growth from the companies you're investing in.
- The dividend yield is an indication of the value of a stock. A high dividend yield suggests a stock's price may be lower than the rest of the market when compared to the income stream it is generating. This is why a 'yield discipline' can help fund managers to outperform- by buying stocks at a high yield and selling them at a low yield,to buy low and sell high, with profits continually being recycled into more undervalued areas.
- Companies that pay high dividends tend to be more robust and focused on feeding cash through to shareholders. Meanwhile plenty of small, exciting growth companies that don't pay a dividend ultimately fail. There are certainly opportunities amongst this latter type of stock, but they need to be picked out selectively. This perhaps goes some way to explaining the huge differential between the performance of higher yielding and lower yielding small cap stocks.

Income funds for long term growth

In our view equity income is simply one of the best areas for the long term investor to be in. This sector is blessed with some of the most talented fund managers. Neil Woodford, manager of Woodford Equity Income, needs no introduction.

Slightly lesser known names include Leigh Harrison who runs the Threadneedle UK Equity Income fund, Adrian Frost who runs Artemis Income, and Giles Hargreave and Siddarth Chand Lall who both run the Marlborough Multi-Cap Income fund. This latter offering carries a high exposure to mid and small cap companies- a hunting ground of exciting opportunities for quality stock-pickers like Hargreave and Lall.

For passive investors Vanguard has launched a UK Equity Income fund, which invests in the top 50% of dividend payers in the UK, Vanguard FTSE UK Equity Income Index.

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NOTES TO EDITORS

Important notes

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About Hargreaves Lansdown

We are a leading provider of investment management products and services to private investors in the UK.

We have a diversified business with an established reputation for providing the best information, service and value for money investments and products to private and corporate investors.

The HL Vantage Service is the largest direct to consumer investment and pension supermarket in the UK.

We administer over £46.3 billion of client assets through the Vantage Service directly on behalf of over

675,000 investors. In total, we have £49.1 billion of assets under administration and management (31st December 2014) and are currently listed in the FTSE 100.

We were started in Bristol by Peter Hargreaves and Stephen Lansdown in 1981 and the majority of our 904 employees are still based here in Bristol.

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