

Euro Dividend Aristocrats

Playing the Continued Recovery

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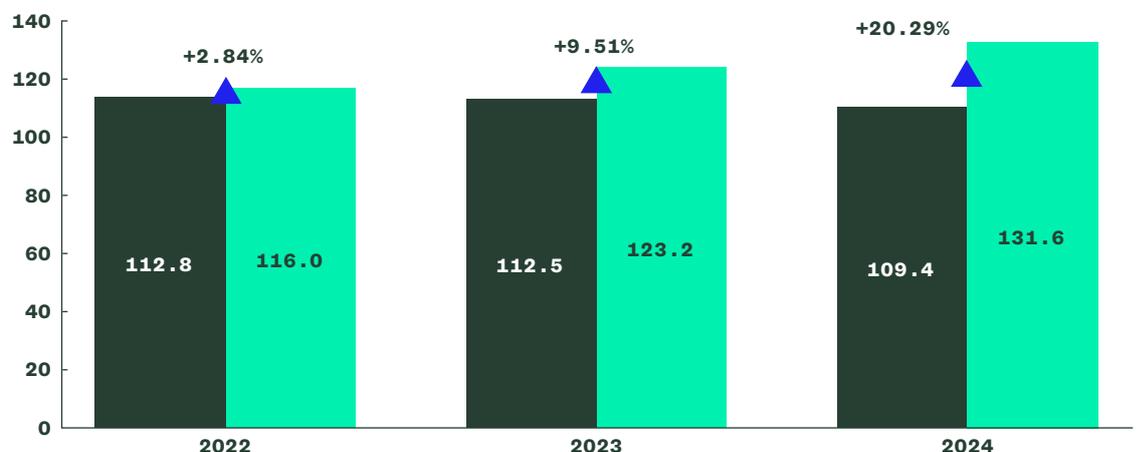
- Market sentiment continues to favour an economic recovery in 2021, as vaccination programmes help support a pickup in business activity
- Companies are keen to renew their commitments on returning capital to shareholders through dividends
- A stable dividend strategy, such as the Dividend Aristocrats indices tracked by SPDR ETFs, aim to offer investors strong yield factor exposure through higher quality stocks from a diverse range of sectors

The strong economic recovery in 2021 provides a supportive case for dividend stocks, as a steady pick-up in consumer activity continues to drive improvements in sentiment. Analysts remain positive that the stabilisation of cash flows will support dividend growth. This extension of the recovery should see investors considering an allocation to dividend strategies, using Smart Beta ETFs, in order to play this theme.

In this note, we highlight the potential opportunity to benefit in this environment from a Dividend Aristocrats approach, the leading dividend index in European Smart Beta ETFs.

Figure 1
**EURO STOXX 50®
Annual Dividend
Outlook**

■ Current Dividend Level (Futures)
■ JPM/Consensus Bottom-up Estimates
▲ Upside (Downside) Potential



Source: JP Morgan Global Dividend Review as of 12 October 2021. JPM/Consensus bottom-up estimates are based on aggregated J.P. Morgan analyst dividend per share estimates, where available, or IBES/Bloomberg consensus estimates.

Macroeconomic Outlook for Dividends

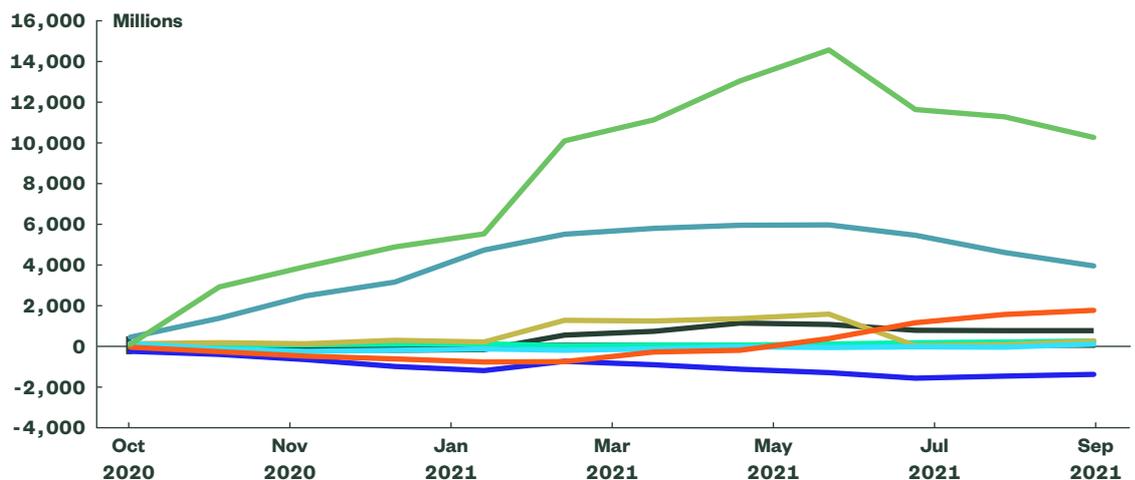
The change in economic sentiment at the end of 2020 laid the foundation for companies to reflect a more positive outlook in their 2021 earnings guidance. After three quarters of reporting, we have clearly seen a pickup in consumer activity to justify the more positive market sentiment, which analysts expect to continue through year end. One of the most profound areas where this impact was felt was in dividend expectations. This earnings season, dividend investors heard a number of positive themes that helped shape the future estimates on forward dividends, as displayed in Figure 1 (previous page). In eurozone equities, three major tailwinds support the ongoing case for investors to consider increasing yield factor exposure by allocating to dividend stocks:

- Analyst estimates reflect significant upside potential for dividends, compared to the present value of dividend futures
- As business activity resumes, further improvement to fundamentals and earnings expectations could provide additional momentum for analyst revisions to go even higher
- Dividend strategies — such as Dividend Aristocrats — offer significant exposure to sectors which maintain relatively attractive valuations and should benefit from further economic refutation

Many companies were forced to increase capital expenditure to retrofit their business for a world experiencing a global pandemic. At the same time, top-line revenues came under pressure from a fall in consumer demand. Such an environment makes it difficult for firms to generate the cash flows required to maintain, or increase, the return of investment capital to shareholders. These firms will be keen to renew their commitment to shareholders through dividends, as business activity continues to pick up. This should benefit the relative valuations of dividend stocks, which were heavily discounted and under-owned since 2020.

While investor sentiment has become more positive on dividend stocks, investor flows have yet to follow at the same rate seen for other recovery exposures, such as Size and Value. As Figure 2 demonstrates, European Smart Beta investors have been pouring money into Size and Value ETFs over the last 12 months, when news on the deployment of vaccines affected asset prices. Dividend ETFs have yet to experience similar inflows but can likely expect to see investors return to these exposures as the economic recovery persists. This further supports the valuation case for dividend stocks.

Figure 2
European-Listed Smart Beta Flows (Last 12 Months, USD)



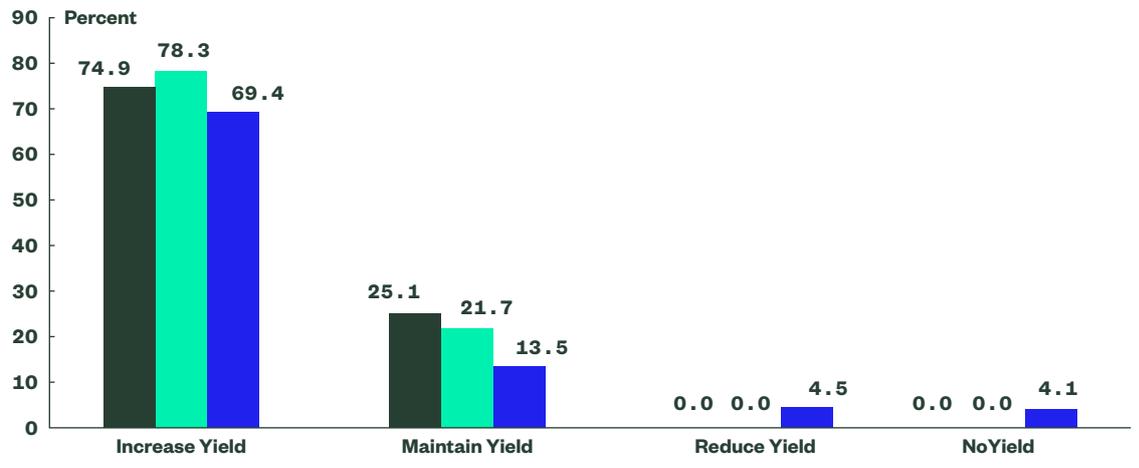
Source: Bloomberg Finance L.P., as of 30 September 2021. Flows are as of date indicated and shouldn't be relied thereafter.

Dividend Aristocrats Targets Stocks Increasing Dividends

The *S&P Euro High Yield Dividend Aristocrats® Index* (“Euro Dividend Aristocrats”) — which is the eurozone regional exposure of the Dividend Aristocrats family — selects stocks that have increased or maintained a stable total dividend per share amount every year for at least 10 consecutive years.¹ By adding Euro Dividend Aristocrats to the portfolio, investors can increase exposure to stocks forecasting an increase in dividend yields, both in terms of portfolio weight (Figure 3) and nominal stock exposure (Figure 4), as compared to a benchmark MSCI EMU Index.

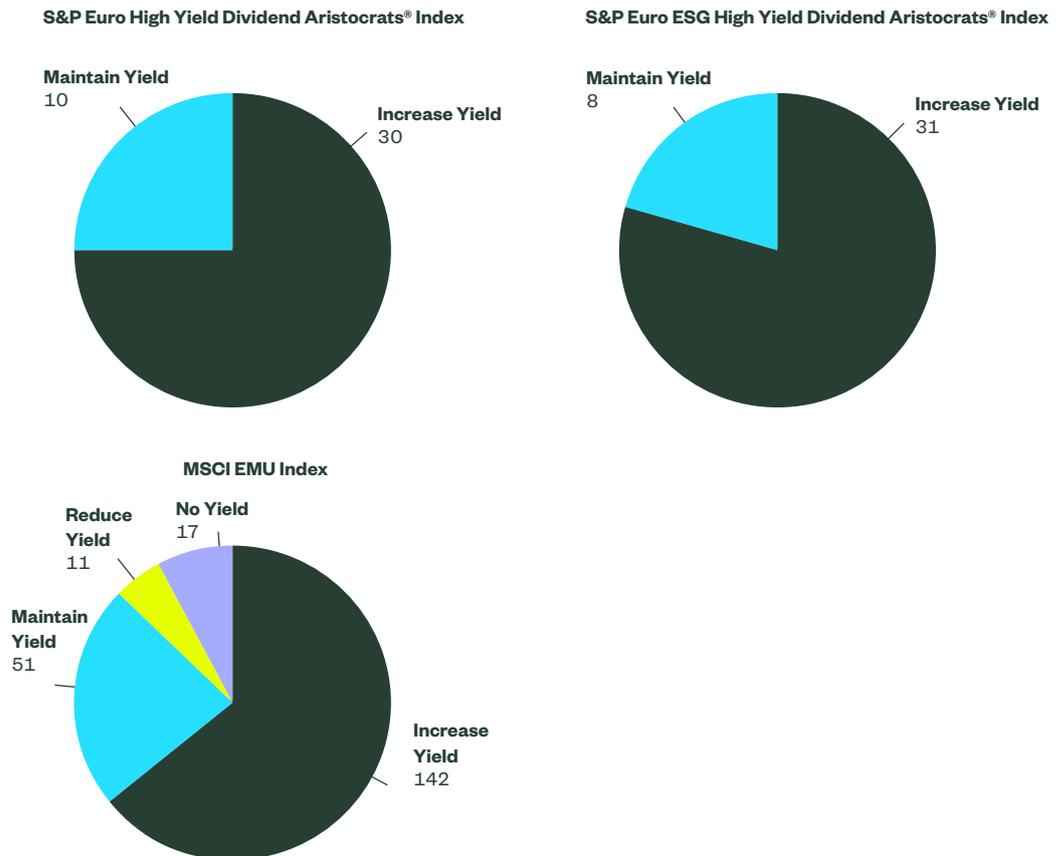
Figure 3
**Total Portfolio
Exposure by
Forecast Action**

■ S&P Euro High Yield Dividend Aristocrats® Index
■ S&P Euro ESG High Yield Dividend Aristocrats® Index
■ MSCI EMU Index



Source: Bloomberg Finance L.P., as of 1 October 2021. Projected characteristics are based upon estimates and reflect subjective judgements and assumptions. There can be no assurance that developments will transpire as forecasted and that the estimates are accurate.

Figure 4
**Total Number
of Stocks by
Forecast Action**



Source: Bloomberg Finance L.P., as of 1 October 2021. Projected characteristics are based upon estimates and reflect subjective judgements and assumptions. There can be no assurance that developments will transpire as forecasted and that the estimates are accurate.

The relative increase in exposure to stocks increasing and maintaining yields may seem lower than expected, given the selection criteria of Euro Dividend Aristocrats. This further emphasises the point made in Figure 1 that eurozone equity dividend expectations are positive for 2022.

Increase Quality by Focusing on Stability

The Dividend Aristocrats indices produce 'quality' income for investors by focusing, and selecting, on a long-term track record of dividend stability. This is unique from other eurozone dividend indices, which may focus primarily on high dividend payers or a high concentration select approach. Pure high dividend indices may increase the risk of exposure to 'dividend traps'. High concentration select dividend indices may expose investors to higher leverage, with respect to both fundamentals and factor risk. Figure 5 highlights some of the key distinctions between these construction methodologies.

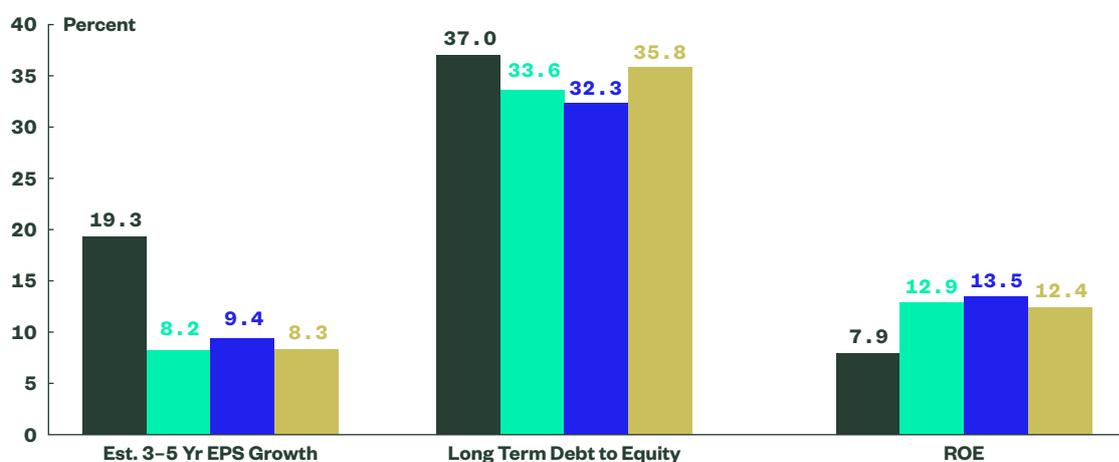
Figure 5
Main Index Methodologies Targeting Dividend Stocks in Eurozone Equities

	S&P Euro (ESG) High Yield Dividend Aristocrats® Index	MSCI EMU High Dividend Yield Index	EURO STOXX® Select Dividend 30 Index
Ticker	SPEUHDAN Index SPEHDAEN Index (ESG)	M4EMHDVD Index	SD3T Index
Selection Universe	S&P Eurozone Broad Market Index	MSCI EMU Index	EURO STOXX® Index
Construction	Select stocks which have maintained increasing or stable dividends every year for at least 10 consecutive years	Select stocks with at least a 30% higher dividend yield, relative to the selection universe, and pass dividend sustainability screens	Select 30 stocks which have the highest dividend yield relative to their home market
Weighting Scheme	Price-weighted with a weighting factor based on the indicated annual dividend yield	Market-capitalisation weighted after selection	Price-weighted with a weighting factor based on the indicated annual dividend yield
ESG	No Bottom 25% DJI ESG Scores No Business Activity violations No Bottom 5% S-Ray UNGC Scores (Conditional SAM MSA review)	None	None
Constraints	5% single stock weight cap 30% sector weight cap 30% country weight cap	5% single stock weight cap	15% single stock weight cap
No. of Holdings	Target 40	Floating	Target 30
Rebalance Frequency	Annual reconstitution (June) with a Quarterly review and conditional Monthly review	Semi-Annual review (May and November)	Annual review (March) with a conditional Fast exit

Source: S&P Dow Jones Indices, MSCI, STOXX. The information contained above is for illustrative purposes only.

While the Dividend Aristocrats strategy does not explicitly target fundamental quality metrics in stock selection, it is not surprising that the Euro Dividend Aristocrats can result in superior quality metrics (Figure 6) compared to a pure high yield index. Dividend indices are inherently biased toward value stocks and away from growth, but the Euro Dividend Aristocrats Index provides similar expected earnings growth (3–5 years) to a pure high dividend index, with lower leverage (long-term debt to equity) than both the pure high dividend strategy and a benchmark EURO STOXX® Index.

Figure 6
Dividend Aristocrats Quality Exposure (vs. High Dividend)

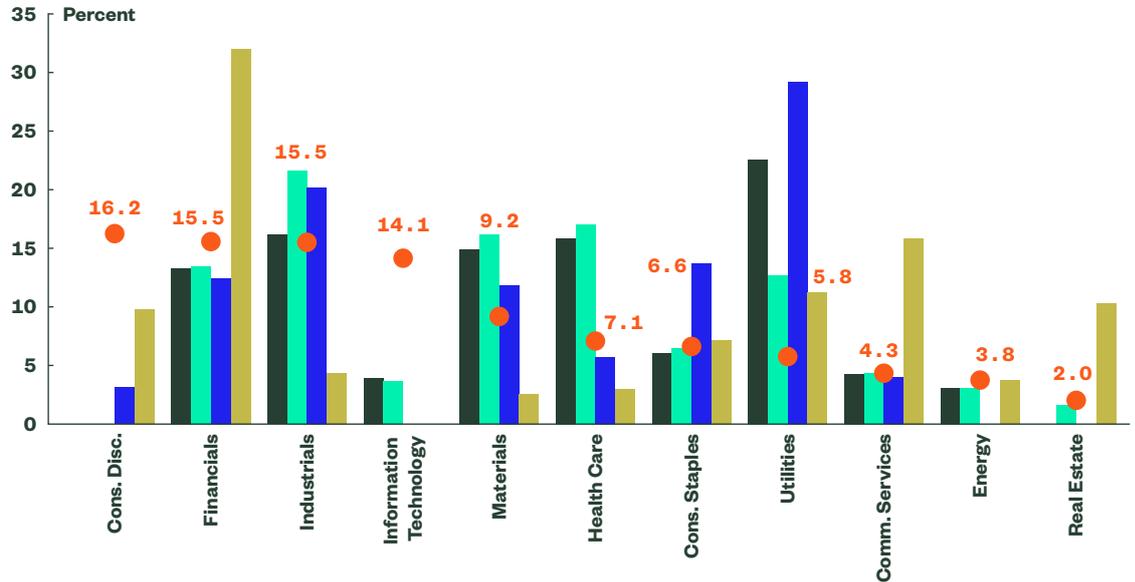


Source: FactSet as of 1 October 2021.

A Balanced Sector Approach to Quality Income

The Euro Dividend Aristocrats Index uses a balanced approach to targeting quality income. The strategy does restrict index exposure to a maximum weight of 5% (single stock), 30% (sector) and 30% (country) at each quarterly rebalancing. This allows the strategy flexibility to go 'wherever it needs' to find quality income, while also promoting adequate diversification. Historically, this has created significant sector biases. Ultimately, investors tend to favour this feature as it offers a balanced diversification from the benchmark, whereas other strategies may provide investors too strong of a concentrated exposure.

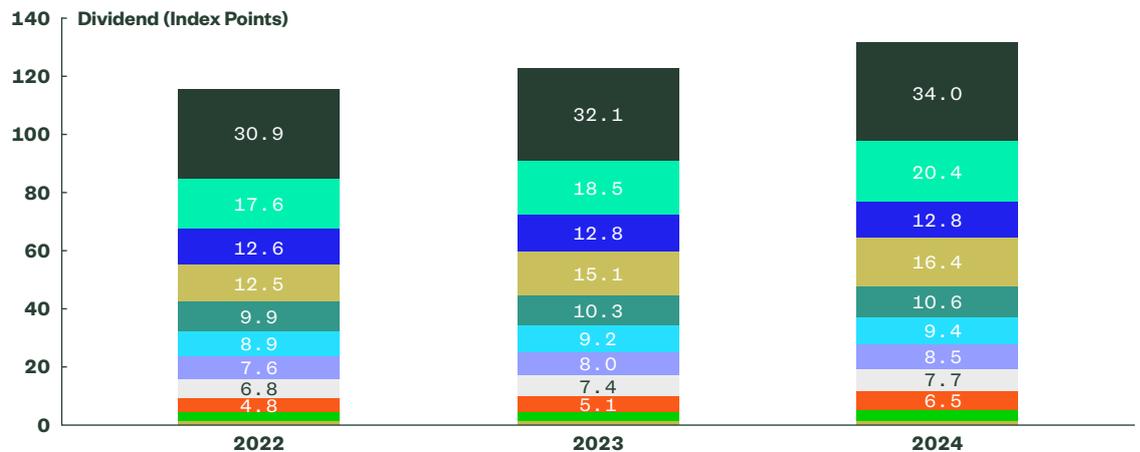
Figure 7
Sector Allocation of Dividend Strategies (vs. EURO STOXX® Index)



Source: FactSet, BarraOne as of 1 October 2021. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown. It is not known whether the sectors shown will be profitable in the future. Diversification does not ensure a profit or guarantee against loss.

If we take a deeper dive into the dividend estimates for the EURO STOXX® 50 Index, we can see that all sectors are expected to deliver positive dividend growth in the coming years. One notable sector that the Euro Dividend Aristocrats Index is overweight is industrials. If we take a deeper dive into the dividend estimates for the EURO STOXX 50®, we can see this sector is expected to deliver a significant portion of the dividend growth in the coming years. In 2022, the 12-month forward dividend expectation is +20.9% in industrials. This growth rate is +8.6% the following year (one of the strongest and most stable growth expectations we can see).

Figure 8
Sector Distribution of Dividend Estimates (EURO STOXX 50®)



Source: JP Morgan Global Dividend Review as of 12 October 2021. JPM/Consensus bottom-up estimates are based on aggregated J.P. Morgan analyst dividend per share estimates, where available, or IBES/Bloomberg consensus estimates.

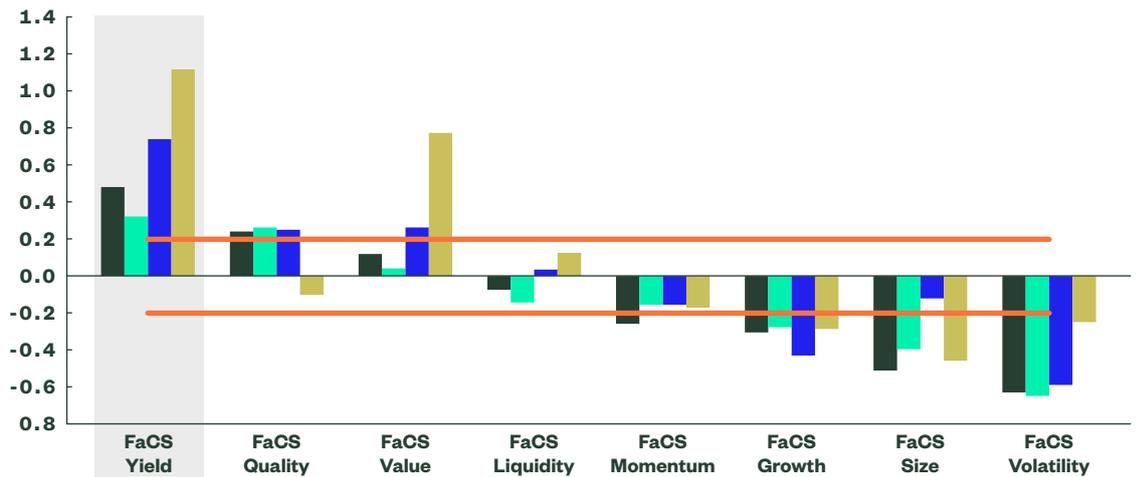
A Balanced Yield Factor Approach to Quality Income

In addition to the sector flexibility offered by the Dividend Aristocrats approach, the yield-weighted strategy is also balanced in seeking yield factor exposure from the basket of highly stable (by historical standards) dividend-paying stocks. In Figure 9, we see Euro Dividend Aristocrats has a significantly strong, but not over-levered active exposure to the Yield factor.

Construction of the Euro Dividend Aristocrats strategy starts with a broad market index (S&P Eurozone) selection universe, but is ultimately a yield-weighted strategy. For this reason, it comes as no surprise that the strategy has a significant negative active Size factor exposure compared to the market-capitalisation weighted EURO STOXX® Index. Figure 10 demonstrates how Euro Dividend Aristocrats is able to offer significant yield factor exposure while maintaining a balanced country risk profile.

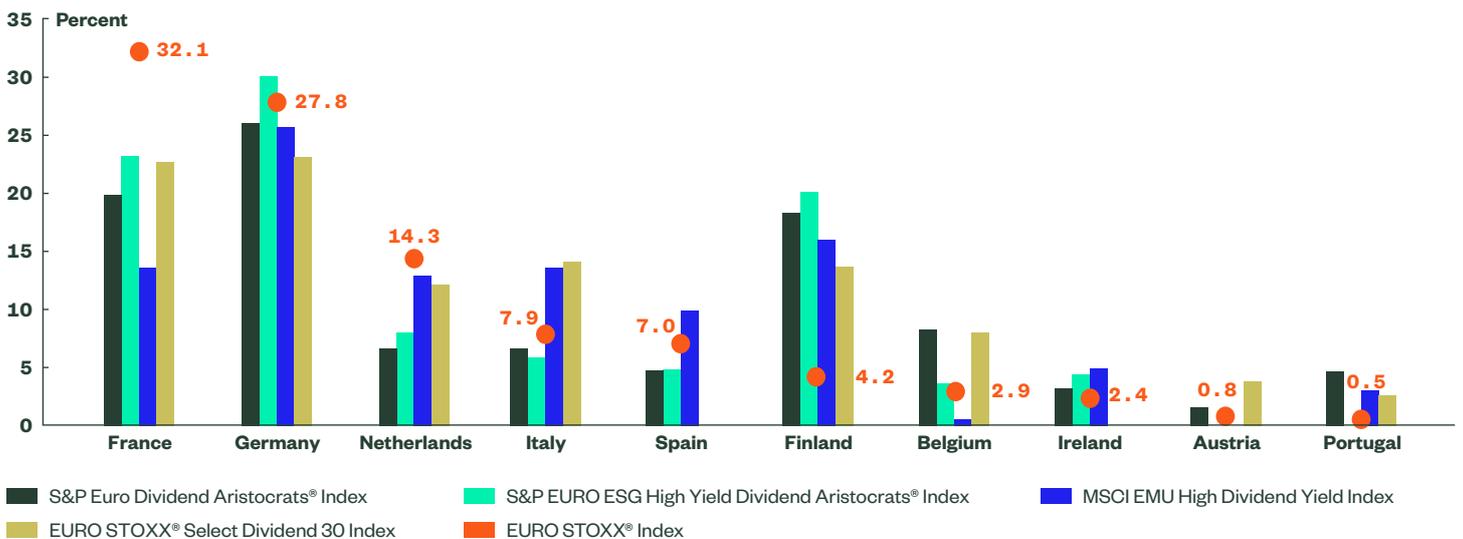
Figure 9
FaCS Active Exposure Comparison
(vs. EURO STOXX® Index)

- S&P Euro High Yield Dividend Aristocrats® Index
- S&P Euro ESG High Yield Dividend Aristocrats® Index
- MSCI EMU High Dividend Yield Index
- EURO STOXX® Select Dividend 30 Index
- Significance Level (± 0.2)



Source: Factset, MSCI BarraOne as of 1 October 2021. Comparison benchmark is the EURO STOXX® Index. FaCS stands for MSCI Factor Classification Standards.

Figure 10
Country Allocation of Dividend Strategies
(vs. EURO STOXX® Index)



Source: FactSet, BarraOne as of 1 October 2021. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown. It is not known whether the sectors or securities shown will be profitable in the future. Diversification does not ensure a profit or guarantee against loss.

Conclusion

Current economic sentiment provides a supportive case for dividend stocks based on recent earnings guidance, analyst projections and general optimism towards a continued economic recovery. This environment could present an opportunity for European ETF investors to return to dividend strategies, following momentum seen in other recovery plays.

The S&P Euro High Yield Dividend Aristocrats® Index is a stable dividend strategy that selects stocks that have increased or maintained a stable total dividend per share amount every year for at least 10 consecutive years. By adding Euro Dividend Aristocrats to the portfolio, investors can increase exposure to stocks forecasting an increase in dividend yields. In addition, the strategy can provide investors with positive quality bias, less concentration and lower leverage, through a balanced approach to strong yield factor exposure.

SPDR® ETFs

The investment objective of the SPDR® family of Dividend Aristocrats indices is to track the performance of equities that historically have exhibited stable dividend growth.

- **SPDR® S&P® Euro Dividend Aristocrats UCITS ETF (Dist)**

The SPDR® S&P® Euro Dividend Aristocrats® UCITS ETF seeks to replicate the S&P Euro High Yield Dividend Aristocrats® Index, which consists of the 40 highest dividend-yielding stocks in the S&P Eurozone Broad Market Index ("BMI") that have increased or maintained stable dividends every year for at least 10 consecutive years. These stocks have both capital growth and dividend income characteristics, as opposed to stocks that are pure yield or pure capital oriented.

- **SPDR® S&P® Euro Dividend Aristocrats ESG UCITS ETF (Dist)**

The SPDR® S&P® Euro Dividend Aristocrats ESG UCITS ETF seeks to replicate the S&P Euro ESG High Yield Dividend Aristocrats® Index, which measures the dividend yield-weighted performance of S&P DJI ESG Score-screened companies within the S&P Eurozone BMI that meet specific ESG criteria and have followed a managed-dividends policy of consistently increasing or maintaining dividends every year for at least 10 years.

Figure 11
Standard Performance

Fund/Index Name	1 Month	3 Months	6 Months	Year to Date	1 Year	3 Years	5 Years	Since Inception
Inception Date 14/10/2011								
SPDR® S&P® Euro Dividend Aristocrats UCITS ETF	-4.54	0.02	3.16	10.83	19.16	3.11	4.61	7.86
S&P Euro High Yield Dividend Aristocrats® Index	-4.59	0.00	2.90	10.50	18.91	2.71	4.20	7.50
Difference	0.05	0.02	0.26	0.33	0.25	0.40	0.41	0.36
MSCI EMU Index†	-3.37	0.31	6.12	15.63	30.35	7.82	8.78	8.84
Difference	-1.17	-0.29	-2.96	-4.80	-11.19	-4.71	-4.17	-0.98

Source: State Street Global Advisors, *Morningstar and Bloomberg, as of 30 September 2021.

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Endnote

1 Full index methodology is available at spglobal.com.

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