

USA Dividend Aristocrats

Playing the Continued Recovery

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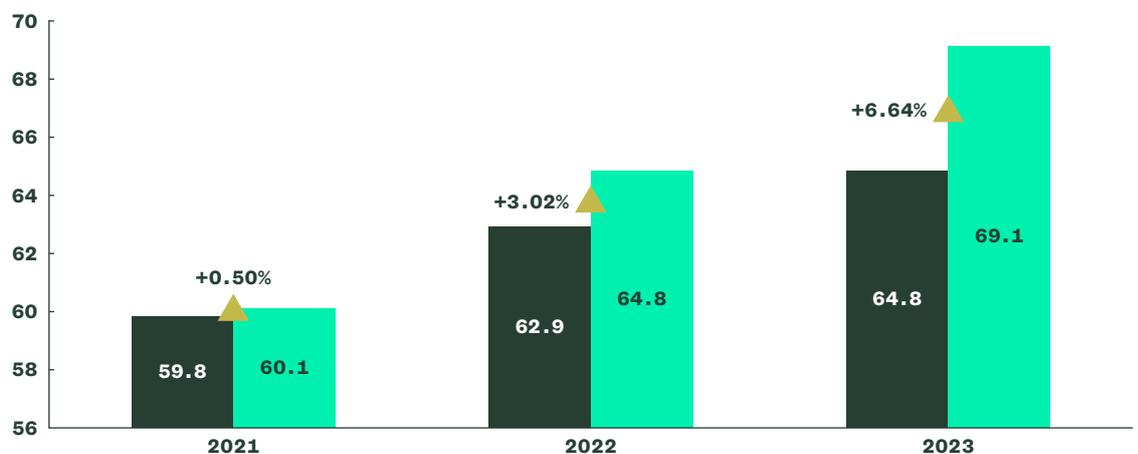
- Market sentiment continues to support an economic recovery in 2021, as vaccination programs help support a pickup in business activity
- Companies are keen to renew their commitments on returning capital to shareholders through dividends
- A stable dividend strategy, such as the Dividend Aristocrats 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 supportive case for dividend stocks, as a steady pick up in consumer activity continues to drive increases 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
S&P 500 Annual Dividend Outlook

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



Source: J.P. Morgan Global Dividend Review, as of 31 August 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

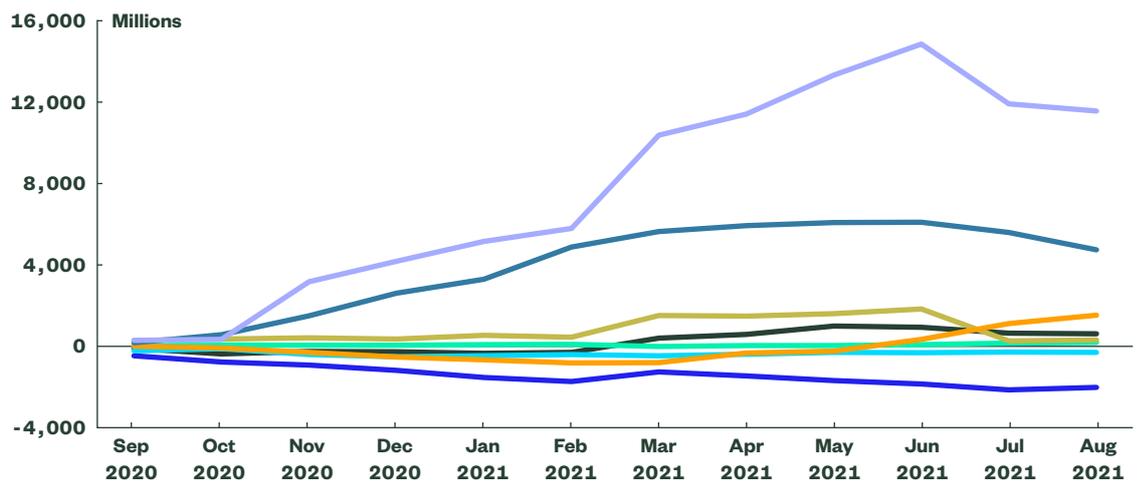
The change in economic sentiment at the end of 2020 laid the foundation for companies to reflect a more positive outlook in their 2021 earnings guidance. After two quarters of reporting, we have clearly seen a pickup in consumer activity to justify the more positive market sentiment, which analysts expect 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 US 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 continues to increase, 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 reflation

Many companies were forced to increase capital expenditure to retro-fit their business for a world experiencing a global pandemic. At the same time, top line revenues were under pressure from a decrease 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)



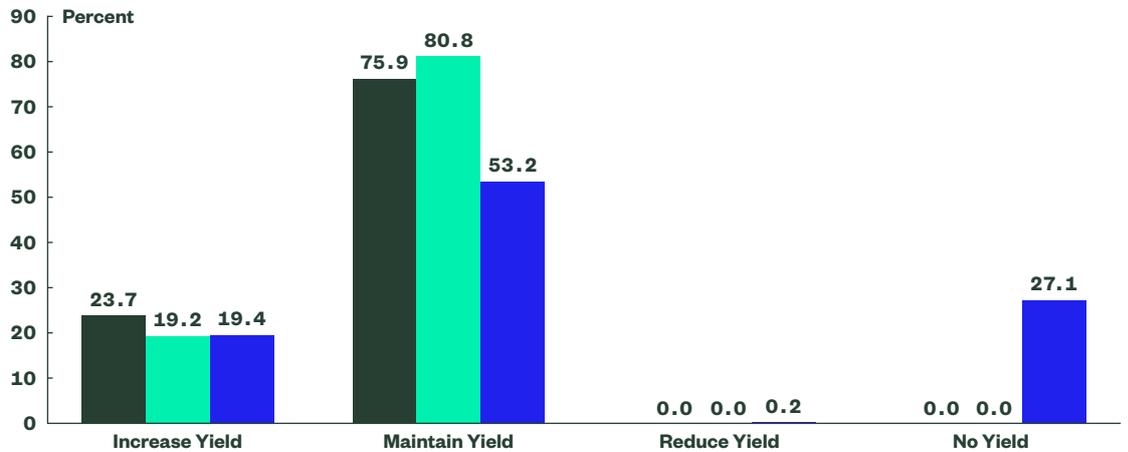
Source: Bloomberg Finance L.P., as of 31 August 2021. Flows are as of date indicated and shouldn't be relied thereafter.

Dividend Aristocrats Targets Stocks Increasing Dividends

The S&P® *High Yield Dividend Aristocrats Index* (“US Dividend Aristocrats”) — which is the United States regional exposure of the Dividend Aristocrats family — selects stocks that have increased total dividend per share amount every year for at least 20 consecutive years.¹ By adding US 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 the S&P® 500 Index.

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

■ S&P High Yield Dividend Aristocrats® Index
■ S&P ESG High Yield Dividend Aristocrats® Index
■ S&P 500® Index



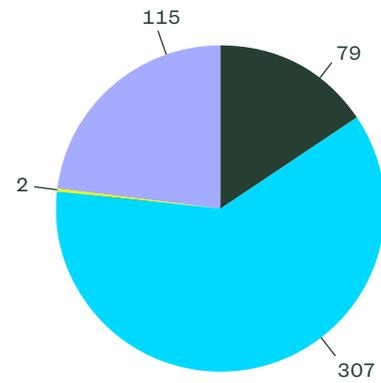
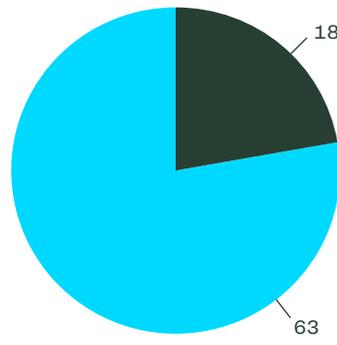
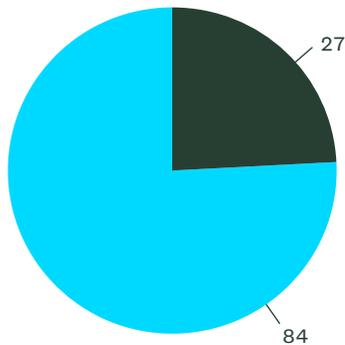
Source: Bloomberg Finance L.P., as of 1 September 2021. Projected characteristics are based upon estimates and reflect subjective judgements and assumptions. There can be no assurance that developments will transpire as forecasted and that the estimates are accurate.

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

S&P High Yield Dividend Aristocrats® Index

S&P ESG High Yield Dividend Aristocrats® Index

S&P 500® Index



■ Increase Yield ■ Maintain Yield ■ Reduce Yield ■ No Yield

Source: Bloomberg Finance L.P., as of 1 September 2021.

The relative increase in exposure to stocks increasing and maintaining yields may seem lower than expected, given the selection criteria of US Dividend Aristocrats. This further emphasises the point made in Figure 1 that US equity dividend expectations are positive for 2021. Less than 1% of the S&P® 500 Index is currently forecasting a dividend cut.

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 US dividend indices, which may focus primarily on high dividend payers or sector-neutral income. Pure high dividend indices may increase the risk of exposure to ‘*dividend traps*’. Sector-neutral dividend indices may dilute an investor’s desired diversification and run the risk of ‘*closet indexing*’. Figure 5 highlights some of the key distinctions between these construction methodologies.

Figure 5
Index Methodologies Targeting Dividend Stocks in US Equities

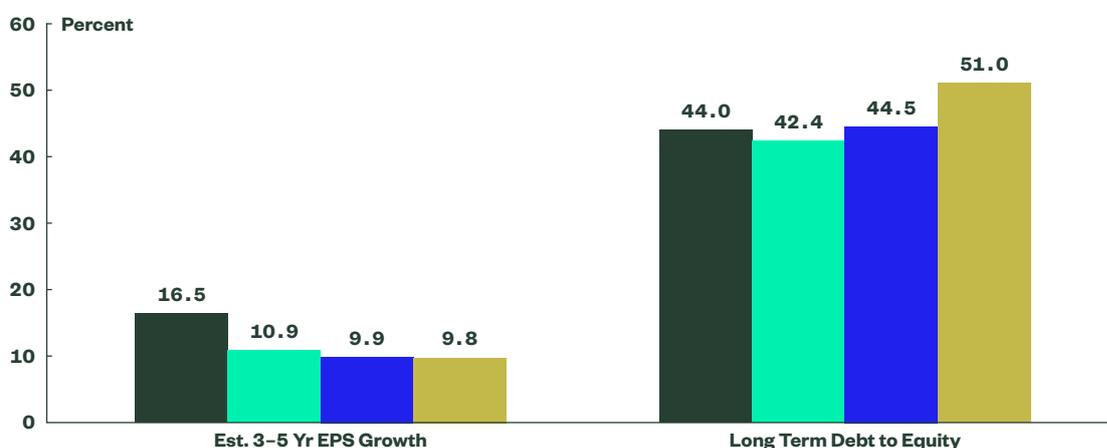
	S&P (ESG) High Yield Dividend Aristocrats® Index	MSCI USA High Dividend Yield Index	Fidelity U.S. Quality Income Index
Ticker	SPHYDAN Index SPEHYDUN Index (ESG)	M1USADVD Index	FIDUSQIN Index
Selection Universe	S&P Composite 1500®	MSCI USA Index	S&P United States Broad Market Index
Construction	Select stocks that have increased dividend every year for at least 20 consecutive years	Select stocks with at least a 30% higher dividend yield, relative to the selection universe, and pass dividend sustainability screens	Screen stocks for low quality, rank stocks by size-adjusted high dividend score and optimise for sector-neutrality
Weighting Scheme	Price-weighted with a weighting factor based on the indicated annual dividend yield	Market-capitalisation weighted after selection	Equal-active weight factor for each stock within sector
ESG	No Bottom 25% DJI ESG Scores No Business Activity violations No Bottom 5% S-Ray UNGC Scores (Conditional SAM MSA review)	None	No Business Activity violations No Non-compliant UNGC principles
Constraints	4% single stock weight cap	5% single stock weight cap	Sector weights reset to be sector-neutral at each reconstitution Stocks are screened to remove the 5% with the lowest price momentum
No. of Holdings	Floating	Floating	Target 125
Rebalance Frequency	Annual reconstitution (January) with a Quarterly review and conditional Monthly review	Semi-Annual review (May and November)	Annual reconstitution (February) with a conditional Monthly review

Source: S&P Dow Jones Indices, Fidelity, MSCI. 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 US 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 US Dividend Aristocrats Index still provides investors exposure to higher expected earnings growth (3–5 years) than a pure high dividend index. Importantly, this earnings growth is achieved with lower leverage (long-term debt to equity) than both the pure high dividend strategy and a benchmark S&P® 500 Index.

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

- S&P 500® Index
- S&P High Yield Dividend Aristocrats® Index
- S&P ESG High Yield Dividend Aristocrats® Index
- MSCI USA High Dividend Yield Index

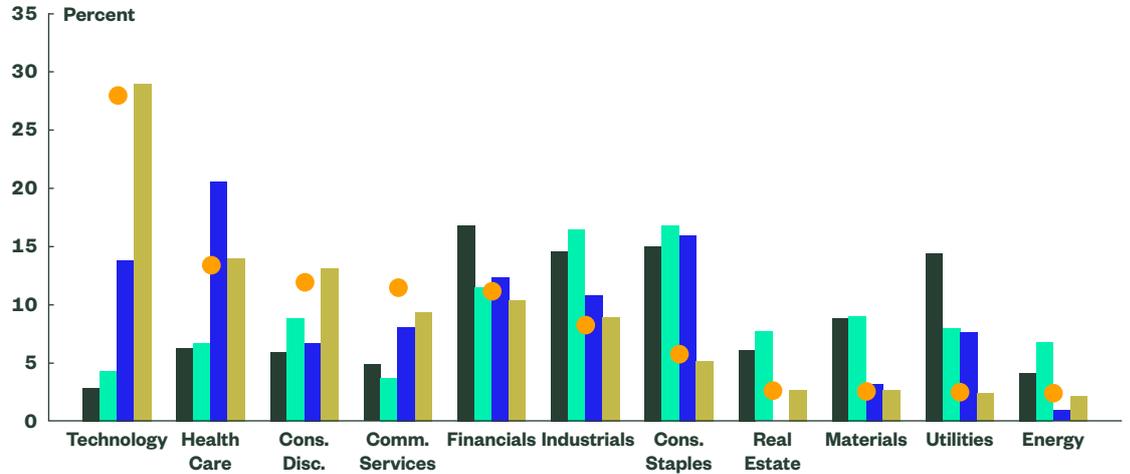


Source: FactSet, as of 1 September 2021.

A Flexible Sector Approach to Quality Income

The US Dividend Aristocrats Index uses a relatively unconstrained approach to targeting quality income. The strategy does restrict each stock to a maximum weight of 4% in the index at each quarterly rebalancing. There are no restrictions in the methodology to limit sector exposure. This allows the strategy maximum flexibility to go *'wherever it needs'* to find quality income. Historically, this has created significant sector biases. Ultimately, investors tend to favour this feature as it offers maximum diversification from the benchmark, whereas other strategies may provide investors too strong of a market-return (higher beta).

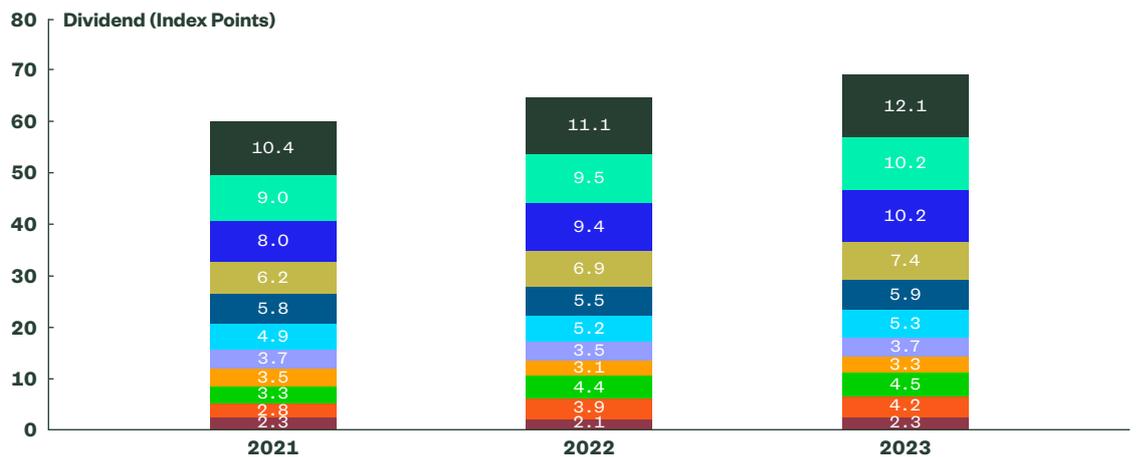
Figure 7
Sector Allocation of Dividend Strategies (vs. S&P 500® Index)



Source: FactSet, BarraOne, as of 31 August 2021. This information should not be considered a recommendation to invest in a particular sector. It is not known whether the sectors shown will be profitable in the future. Diversification does not ensure a profit or guarantee against loss.

One notable sector which the US Dividend Aristocrats Index is uniquely overweight is in Financials. If we take a deeper dive into the dividend estimates for the S&P® 500 Index, we can see this sector is expected to deliver a significant portion of the dividend growth in the coming years. In 2021, the 12-month forward dividend expectation is +17.46% in Financials. This growth rate is +8.01% the following year (one of the strongest and most stable growth expectations we can see).

Figure 8
Sector Distribution of Dividend Estimates (S&P 500®)



Source: JP Morgan Global Dividend Review, as of 31 August 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. Past performance is not a reliable indicator of future performance. This information should not be considered a recommendation to invest in a particular sector. It is not known whether the sectors shown will be profitable in the future.

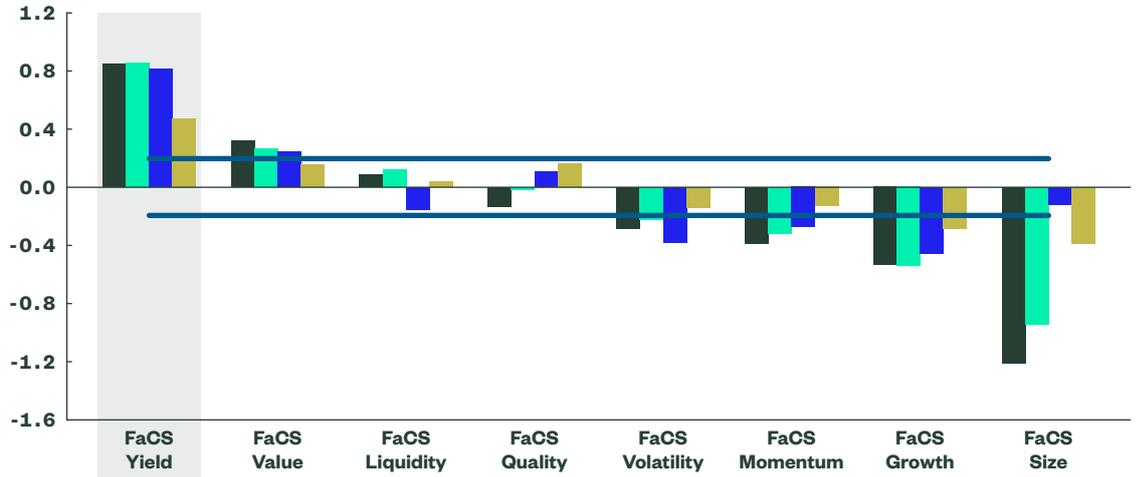
A Flexible Yield Factor Approach to Quality Income

In addition to the sector flexibility offered by the Dividend Aristocrats approach, the yield-weighted strategy is also free to try and maximize its yield factor exposure from the basket of highly stable (by historical standards) dividend-paying stocks. In Figure 9, we see US Dividend Aristocrats has the strongest active exposure to the Yield factor.

Construction of the US Dividend Aristocrats strategy starts with a broad market index (S&P Composite 1500) 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 S&P® 500 Index. Going a layer below (Figure 10) we can see much of this comes from a positive exposure to mid-cap stocks.

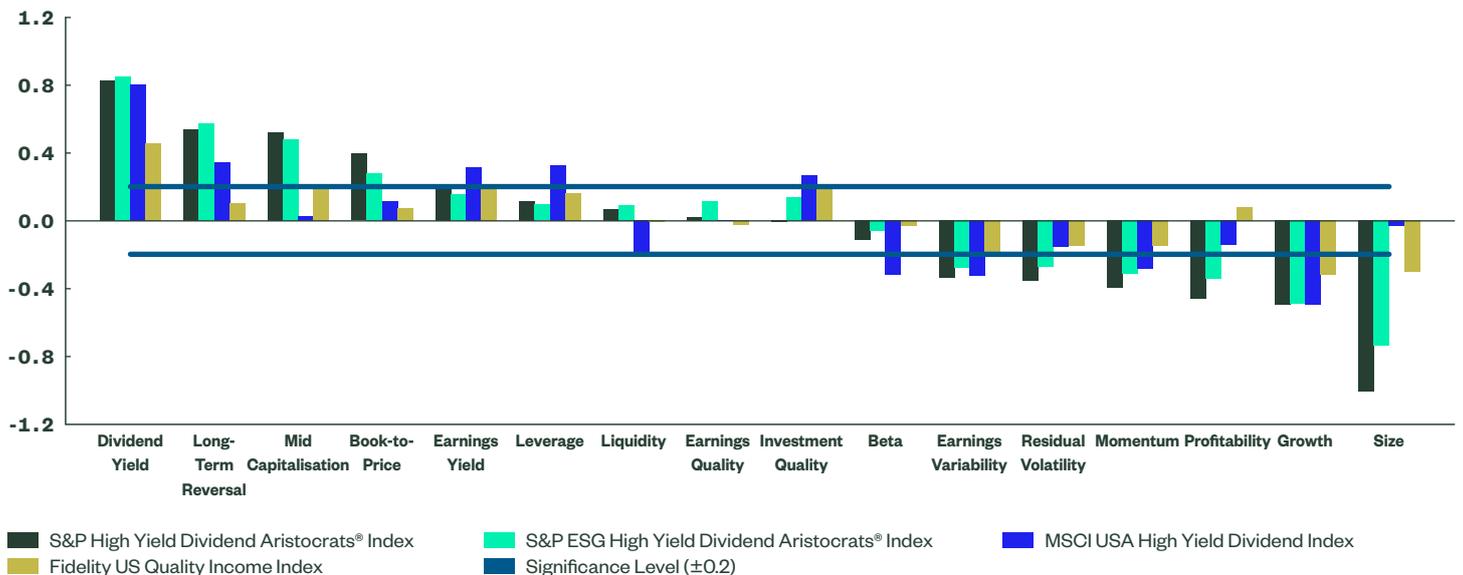
Figure 9
FaCS Active Exposure Comparison
(vs. S&P 500® Index)

- S&P High Yield Dividend Aristocrats® Index
- S&P ESG High Yield Dividend Aristocrats® Index
- MSCI USA High Yield Dividend Index
- Fidelity US Quality Income Index
- Significance Level (±0.2)



Source: FactSet, BarraOne, as of 31 August 2021. Comparison benchmark is the S&P 500® Index. FaCS stands for MSCI Factor Classification Standards. Based on MSCI's Global Equity Factor Model, MSCI FaCS includes 8 Factor Groups, and 16 Factors.

Figure 10
GEMLT Active Exposure Comparison
(vs. S&P 500® Index)



Source: FactSet, BarraOne, as of 31 August 2021. Comparison benchmark is the S&P 500® Index. GEMLT stands for MSCI Barra's Global Equity Model for Long-Term Investors.

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® High Yield Dividend Aristocrats Index is a stable dividend strategy that selects stocks that have increased their total dividend per share amount every year for at least 20 consecutive years. By adding US 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, flexibility in seeking sector diversification and the maximum exposure to the yield factor.

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® U.S. Dividend Aristocrats UCITS ETF (Dist)**

The SPDR® S&P® U.S. Dividend Aristocrats UCITS ETF seeks to replicate the S&P® High Yield Dividend Aristocrats Index, which is comprised of the stocks of the S&P Composite 1500® Index that have increased dividends every year for at least 20 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® U.S. Dividend Aristocrats ESG UCITS ETF (Dist)**

The SPDR® S&P® U.S. Dividend Aristocrats ESG UCITS ETF seeks to replicate the S&P 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 Composite 1500® that meet specific ESG criteria and have followed a managed-dividends policy of consistently increasing dividends every year for at least 20 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® U.S. Dividend Aristocrats UCITS ETF	1.28	0.03	13.84	18.95	32.60	10.89	10.98	13.00
S&P High Yield Dividend Aristocrats® Index	1.27	0.01	13.84	18.97	32.57	10.76	10.90	12.94
Difference	0.01	0.02	0.00	-0.02	0.03	0.13	0.08	0.06
S&P 500® Index ¹	3.00	7.84	19.27	21.23	30.58	17.43	17.35	15.75
Difference	-1.72	-7.81	-5.43	-2.28	2.02	-6.54	-6.37	-2.75

Source: State Street Global Advisors, *Morningstar and Bloomberg, as of 31 August 2021. **(Standard) Performance quoted represents past performance, which is no guarantee of future results. Performance returns for periods of less than one year are not annualised. The performance figures contained herein are provided on a net of fees basis and do reflect the deduction of advisory or other fees. All results are historical and assume the reinvestment of dividends and capital gains. The performance data do not take account of the commissions and costs incurred on the issue and redemption, or purchases and sale, of units. Visit spdrs.com for most recent month-end performance.** Index returns are unmanaged and do not reflect the deduction of any fees or expenses.

Endnote

1 Full index methodology is available at spglobal.com.

ssga.com/etfs

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