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## Dividend Play in Volatile Market?

### Executive Summary

**Outperformance** – Dividend stocks tend to outperform the broad market over long periods.

**Stability** – Dividend stocks provide stability to portfolios during downturns and enhance returns over up-markets.

**Dividend and bond yield** – The 5-Year US Treasury yield is at a historically low level as compared to 1-Year MSCI World Index Dividend Yield.

**Asia Pacific ex Japan Dividend Stocks** - Asia Pacific ex Japan region has witnessed significant earnings and dividend growth over the past 10 years. Upward trend observed in Earnings-Per-Share is likely to continue and translate into dividend payouts.

### Introduction

Dividend stocks generally refer to stocks that pay out significant and regular dividend payments. They provide investors with stable income and can work as a shelter in volatile markets. While that may be the case, investing in a single dividend stock has its risks, such as capital losses or suspension of dividends. Unit trusts that invest in dividend stocks on the other hand, provide diversification and more protection as compared to single dividend stock, and we are positive on the outlook of dividend stock funds for the following reasons:

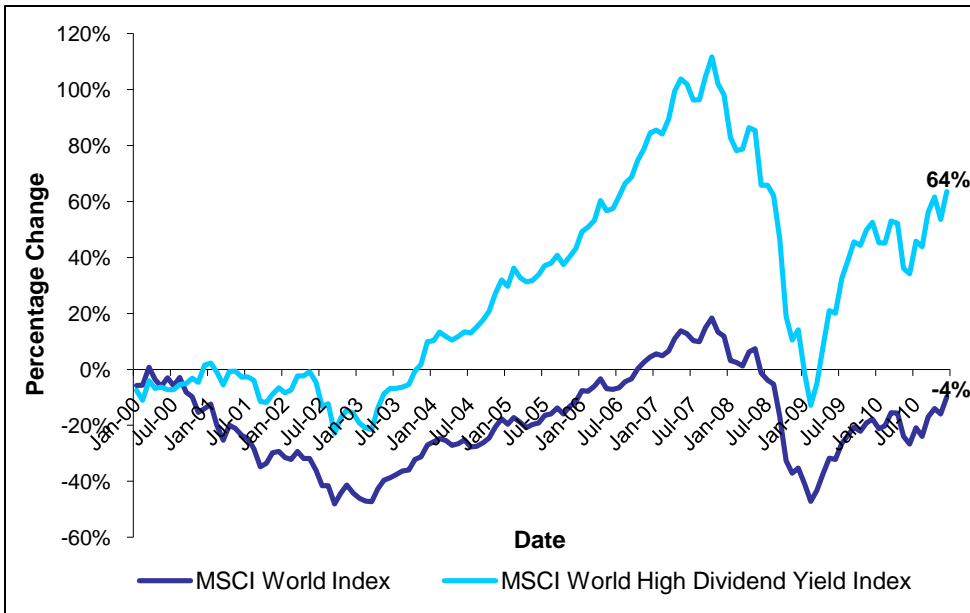
Firstly, high dividend yield stocks tend to outperform the broad markets in the long term. Secondly, dividend yield cushions price fluctuations and offers stability for investors during downturns while enhancing returns over up-markets. Thirdly, the 5-Year US Treasury Yield is at a historically low level as compared to the 1-Year MSCI World Index dividend yield. Lastly, we are positive on the dividend stocks in the Asia Pacific ex Japan region as the recent upward trend observed in the Earnings-Per-Share (EPS) is likely to continue and translate into sustainable dividend payouts for investors.

### Dividend stocks have been outperforming the broad market

Various researches have shown that dividend paying stocks tend to outperform the broad market in long time periods, and the superior returns were not just due to dividend but capital gains as well. Chart 1 shows that the MSCI World High Dividend Yield Index outperformed significantly as compared to the MSCI World Index in the last decade. This means that if investors were able to pick out and invest into high dividend yielding stocks from MSCI World, they will gain 64 percent while those that invest broadly into the MSCI World lose 4 percent over the ten year period.



**Chart 1: Indices levels (1 Jan 2000 to 31 Dec 2010)**



Source: Bloomberg and MSCI, as of 28 Jan 2011

A reason for the out-performance of high dividend yield stocks can be attributed to their sound financial health and stability. To be able to pay out regular and substantial dividends, a company should have excess cash available after reinvestment and other expenses, which eliminates companies that regularly faces cash flow issues. The excess cash available can also buffer against unexpected problems if needs arise, therefore providing greater stability and better financial health.

### Dividend contribute significantly during up- or down-markets

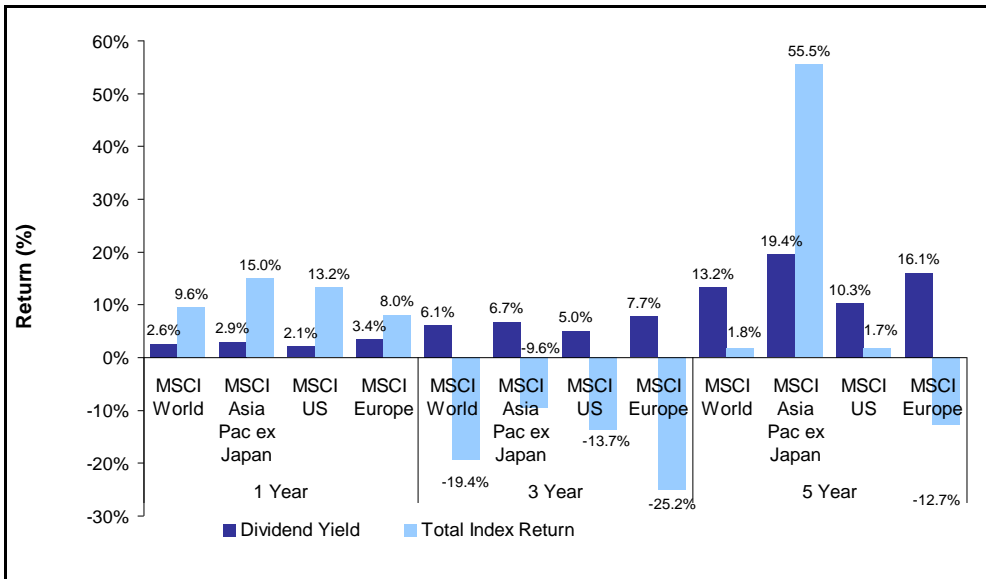
Whether the market is on an upward or downward trend, dividend payouts contribute significantly to investors. As observed in Chart 2, the total returns for indices are largely negative for the 3-Year period. The dividend yields remains generally positive, suggesting that the total index losses could be even larger without dividends. This means that investors of the MSCI Europe Index, which registered a 25.2% loss in the period, can in fact lose more than that if there were no dividend payouts.

In the 1-Year period ending 31 Dec 2010, indices in Chart 2 gained across the board. During up-markets such as this, dividend yield remains a contributing factor to the total index. For example, the MSCI Europe Index gained 8% in 2010 and dividends contributed 3.4% to the gain, almost half of the total index return. Therefore, the non-negative nature of dividend yield allows it to act as cushion against capital losses during down-turns and also boost total return during up-markets.

*The MSCI World High Dividend Yield Index outperformed the MSCI World Index significantly. Other periods were also considered and trend generally persists for long periods.*



**Chart 2: Dividend Yield and Return (Period ending 31 Dec 2010)**

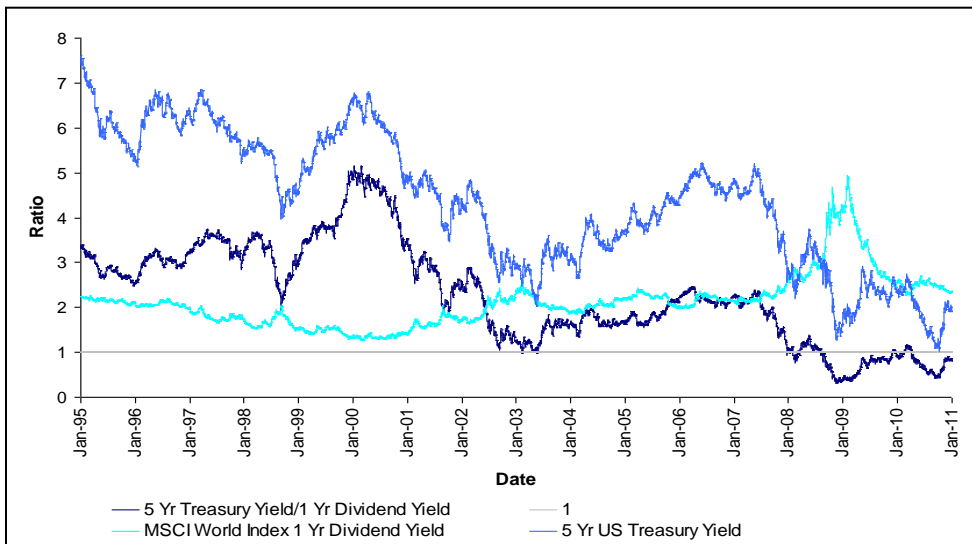


Source: Bloomberg, as of 28 Jan 2011

### Dividend yield vs bond yield

Bonds have been widely viewed as an income generating tool and safety hedge against risky assets. However, accommodative monetary policies in the developed economies have brought interest rates to historically low level, with 1-Year and 5-Year Treasury yields at 0.23 percent and 1.93 percent respectively, as of 31 Jan 2011. This is much lower as compared to the 1-Year dividend yield of MSCI World Index of 2.35 percent and increase the attractiveness of dividend yielding stocks as a source of income.

**Chart 3: 5-Yr Treasury and 1-Yr MSCI World Index Dividend Yield**



Source: Bloomberg, as of 31 Jan 2011

*Dividend stocks provide stability to portfolios during downturns and contribute significantly during upturns*

*The 5-Year US Treasury yield is at a historically low level as compared to 1-Year MSCI World Index Dividend Yield.*



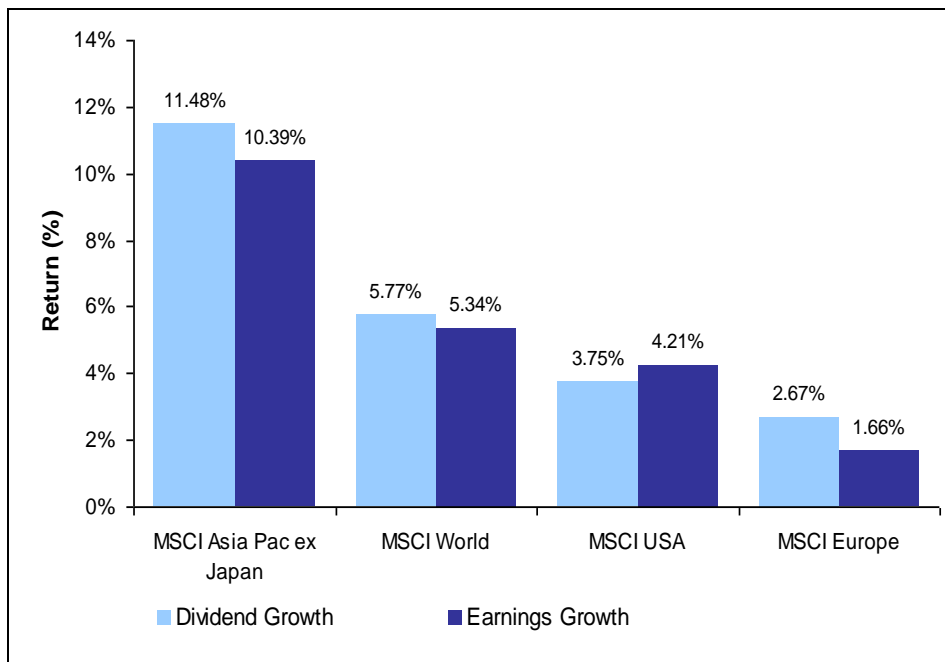
Chart 3 shows the 5-Year US Treasury yield, the 1-Year MSCI World Index dividend yield and their ratio. The 5-Year treasury yield has been consistently higher than the 1-Year dividend yield, until 2008, when recession concerns caused treasury yields to tumble to record lows as investors flee to safety assets. Since then, the ratio of 5-Year Treasury yield to 1-Year dividend yield has trended below or near 1. As of 31 Jan 2011, the 1-Year dividend yield is 2.35 percent while the 5-Year Treasury rate is 1.93 percent, meaning that an investor will gain more income by investing in the MSCI World Index as compared to the 5-Year US Treasury. We feel that the low yield of treasury should prompt investors to consider alternative source of income such as dividend stocks with higher yields.

### Asia Pacific ex Japan Dividend Stocks

Asian companies are holding record level of cash according to a report from Moody's, as quoted by Bloomberg. Specifically, it was mentioned that the average cash holdings per corporate is almost double that of the US companies. The substantial cash holdings in Asian companies will benefit dividend paying stocks due to the improved stability and available cash for dividend payments.

Moody's also added that this increase in cash holdings is mainly attributable to improved operating performances and debt-raising, as quoted by DailyStar. A look at the earnings for various geographical regions reveals that Asia Pacific ex Japan have the highest earnings growth (10.39%) in the past 10 years. (Chart 4) Dividend growth even surpassed the earnings growth in the region, demonstrating the attractiveness and significance of dividends over time.

**Chart 4: Annualised dividend and earning growth (2000-2010)**



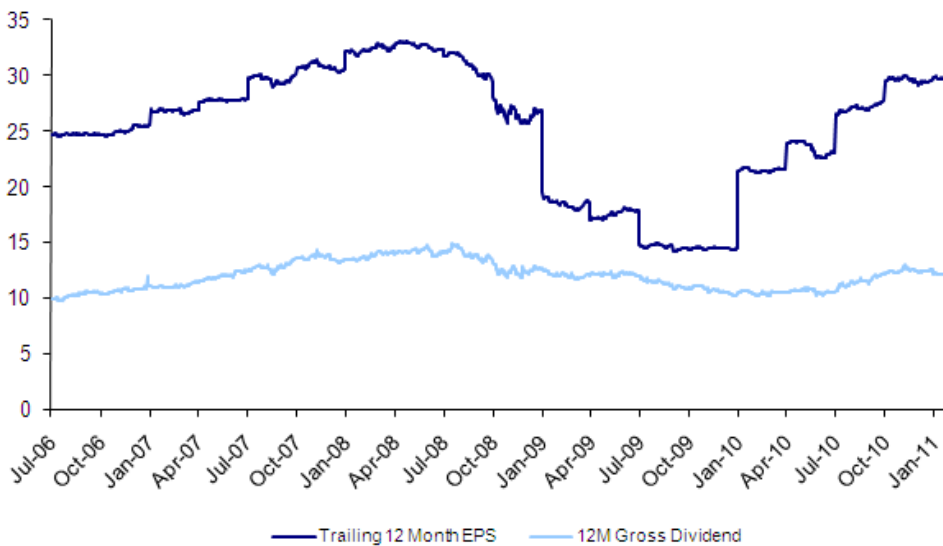
Source: Bloomberg, as of 18 Jan 2011

*Asia Pacific ex Japan region has witnessed significant earnings and dividend growth over the past 10 years.*



Moreover, earnings per share of MSCI Asia Pacific ex Japan Index has recently risen to near pre-crisis levels as shown in Chart 5. Increase in earnings is generally good for dividend stocks as there is a larger pool of cash available for dividend payout as compared to low-earnings periods. We do not foresee inflation issues in Asia to escalate dramatically as governments have started tightening more rigorously in recent months. Coupled with the sound fundamentals of Asia economies, it is likely that the earning levels will be sustained and translated into sustainable dividend payouts for investors.

**Chart 5: MSCI Asia Pacific ex Japan Index**



*EPS of MSCI Asia Pacific ex Japan Index has risen to near pre-crisis level. Dividend level has risen as well but show much lesser volatility as compared to earnings.*

Source: Bloomberg, as of 28 Jan 2011

### Risks of dividend stocks

Investing in dividend stocks is not without risk and we need to pay special attention to them as well. When companies are going through difficult time and face cash flow issues, it is likely that dividend payments will be reduced or suspended for that period. Although this is usually used as a last resort, it can send a negative signal to investors that the company is having financial problem and impact share prices adversely. Therefore, it is important to select companies with stable dividend payment history and have a strong chance of continuing that payment. Investing in dividend paying unit trusts would be a way to do this, it offers diversification and the expertise of professional investors.

Some argue that companies pay substantial dividends to shareholders due to their lack of investment options and thus will have lower growth in the future. We feel that although there may be some truth to this, it may not be the entire picture. The earlier case of MSCI Asia Pacific ex Japan demonstrated that earnings growth can be translated to dividend growth as well, thus growth and dividend stocks may not be mutually exclusive.



### Fund in Focus – Schroder Asian Equity Yield Fund

The Schroder Asian Equity Yield Fund is mainly exposed to Asian ex Japan companies that they believe offer attractive yields and sustainable dividend payments. The Fund aims to make half-yearly distribution of at least 2 cents per unit.

**Table 1: Peer Comparison**

Name	1 Yr Max Drawdown	1 Yr Return	3 Yr Return	1 Yr Sharpe	1 Yr Vol	3 Yr Vol
Schroder – Asian Equity Yield SGD	-10.05	<b>17.57</b>	-0.77	<b>1.47</b>	11.94	21.75
Fidelity – Asia Pacific Dividend A SGD	-14.36	14.3	-0.97	0.82	16.5	17.23
First State – Dividend Advantage SGD	-9.43	11.76	0.34	0.99	11.27	18.81
Henderson – Horizon Asian Dividend Income A2 SGD	-11.49	8	-0.28	0.55	12.83	21.99

\* Returns expressed assume all income are reinvested on a gross basis

Source: Financial Express, as of 31 Jan 2011

The funds chosen for peer comparison against Schroder Asian Equity Yield invest mainly into Asian dividend paying stocks and have a record of paying dividends on either a semi-annual or quarterly basis. Schroder Asian Equity Yield outperformed in terms of 1-Year gross return (17.57%) and 1-Year Sharpe ratio (1.47%). Although it has slightly higher volatility as compared to peers, the higher 1-Year return and Sharpe ratio are attractive for investors looking to take on more risk for higher returns.

**Chart 5: 1 Year Price Return**



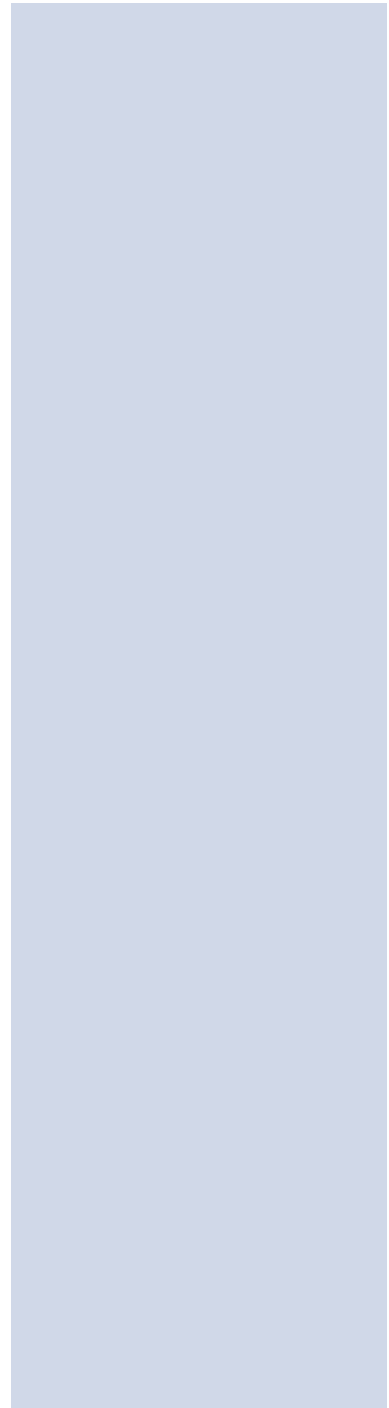
Schroder Asian Equity Yield outperformed its peers on a 1-Year basis in terms of NAV.

\* Returns expressed assume all income not reinvested

Source: Financial Express, as of 31 Jan 2011



Some investors feel that the dividend from funds will cause a drop in Net Asset Value and does not have any real benefits. Chart 4 shows the funds performances from a pure Net Asset Value perspective, excluding dividends. The general uptrend for all funds demonstrate that it is still possible for NAV to rise to provide capital gains, even after paying dividends. Schroder Asian Equity Yield remains the outperforming fund among its peers with a 13.0% gain, demonstrating its superior capital gain in the one year period.





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