EPOCH | Epoch Investment Partners, Inc.

GESY MACRO COMMENTS 3.13.20

Market Environment for Dividend Paying Stocks

Positive exposure to dividend yield stocks has not helped performance YTD, however over the long run dividend paying stocks have performed better than companies that don't pay them at all. This seems intuitive because growing dividends reflect a company's good health and the shareholder orientation of its management team. Once a dividend is paid, regardless of how a stock's price fluctuates from there, you are starting out with the cushion of a positive return. Not only have dividend paying companies and those that grow their dividends outperformed over time, they have also done it with less volatility. Given the need for income in the current market environment, we believe an effective investment strategy is one that focuses on companies that are generating growing streams of cash flow and channeling large portions of that free cash flow to shareholders in the form of cash dividends, share repurchases and debt pay downs. As bond yields continue to move lower, we expect dividends and stock buybacks to remain relevant. Today, the environment for the strategy looks favorable as interest rates remain low and are negative in some cases. Treasury yields have fallen, and bonds are less attractive, but the yield on the strategy remains competitive.

Macro Pressure's Impact on Company Fundamentals

COVID-19 is impacting the fundamentals of certain industries within the consumer discretionary sector such as hotels, restaurants, gaming, luxury goods, cruise operator, among others. It is also affecting global supply chains. Lower interest rates are a headwind for banks given net interest margins are adversely affected. The sharp drop in oil prices is affecting the fundamentals of most energy companies, especially those that are more levered to the oil price. In addition, companies within the chemicals subsector of materials have been affected.

Short- and Long-term Impact of COVID-19, the Treasury yield drop and energy selloff?

From a firmwide perspective, there are many impacts, so here we will just mention three. First, global supply chains have faced severe dislocation. We expect some production, especially for tech hardware and healthcare, to be brought back stateside or to be diversified beyond China. Second, lower rates suggest traditional monetary policy tools are now much less effective. We expect greater coordination with fiscal policy, including some of the elements associated with MMT. This is feasible provided inflation remains tame. Third, OPEC, like all cartels, is fragile, and has become increasingly so with the shale boom. OPEC will likely be less crucial to global crude markets going forward, suggesting prices will be more volatile and, on average, lower in years to come. This backdrop will require oil companies to become better allocators of capital and be more careful about taking on excessive amounts of leverage.

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