Global Income Quarterly – 2020 Update (Q4 2020)

What are the major trends in global income?

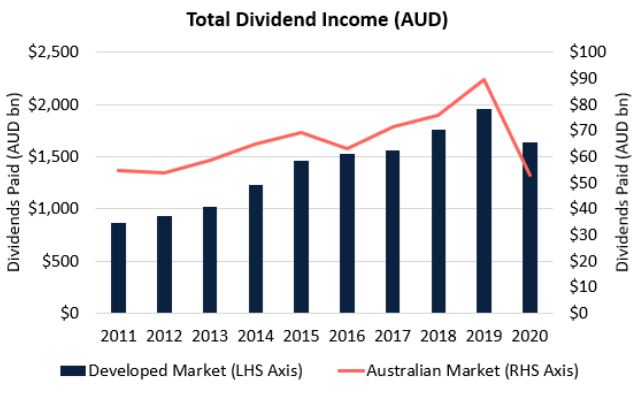
- In AUD terms dividends fell -11% in Q4 2020 (v Q4 2019). Income fell just over -6% in local currency terms. Despite the sustained impact of Covid-19 on company earnings, this reflects a continued improvement in dividend reductions (Q2 -28%, Q3 -13%).

- The effect of currency on dividends in Q4 2020 was -4.9%, due to a broadly stronger $A versus Q4 2019. However when comparing 2020 to 2019, currency added +1.8%.

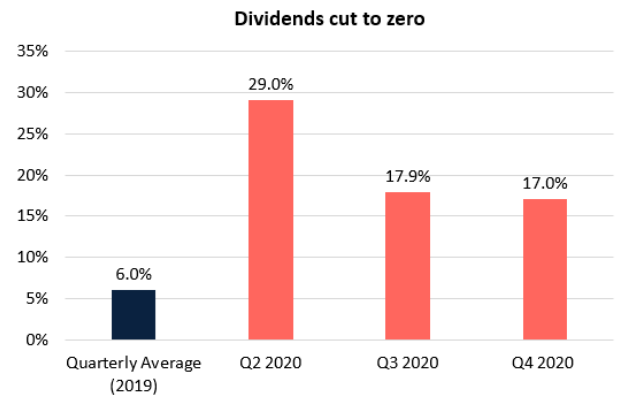
- Global developed market companies still paid out $A323bn in Q4 and $A1.64tn across 2020. 2020 was a departure from the strong dividend growth seen over the last decade, charted below. Our forecasts, discussed later, point to a better picture in 2021.

- The number of companies cutting to zero (17%) remains elevated when compared to a 2019 quarterly average of 6%. Thankfully this remains reduced in comparison to the substantial cuts we saw in Q2 (29%). It's essential investors remain vigilant in how they access yield.

- Despite continued weakness, the Plato Global Equity fund continues to distribute 6.1% p.a. yield since inception. This highlights the continued importance of active management in income generation and avoiding the dividend traps mentioned above.



Source: Factset



Source: Factset

- On the positive side, 39% of dividend paying companies increased or initiated dividends compared to the same quarter last year. However, 15% decreased but still paid a dividend.

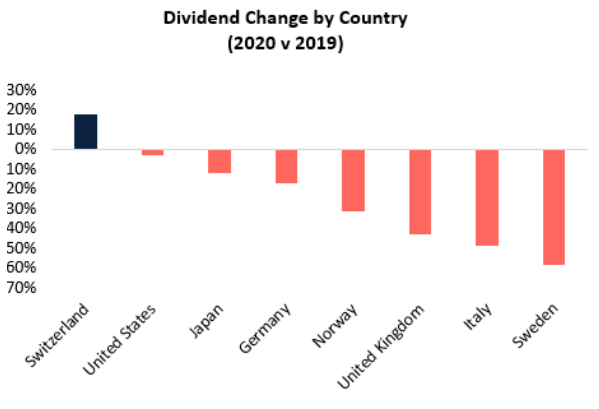
- The list of companies that paid dividends in Q4 2019 and cut to zero in Q4 2020 included large, well known companies like Boeing Company and Burberry Group.

- 52% of companies paid in 2020, down from 65% in 2019.

- Changes in dividends were not uniform. In Q4 Asian dividends continued to have the worst falls (-28.8%). In comparison North America fell -7.8% and European income fell -12.5%. The latter was driven by the UK.

Which countries are leading the charge?

- When comparing the annual trend from 2019 to 2020 Switzerland was the only country to increase dividends in AUD terms. North America was relatively flat, with substantial falls in some European countries, shown in the chart below.
- Focussing on Q4, dividends fell further in most developed market countries (Italy -43%, UK -36%). Scandinavian dividends held up well (Sweden +47%, Norway +23%). Two large countries, which have low payout ratios fell, albeit by less than Q3 (US -8%, Japan -17%).
- Switzerland, Portugal and Germany were large positive outliers driven by stocks, including Volkswagen AG and UBS Group, that traditionally pay in Q2 but deferred to Q4.
- In Q4 dividends contracted -47% in Australia, significantly less than the -70% plus drawdown in Q2 2020. Financials were a significant driver, including Q4 cuts from ANZ, NAB, Westpac and Macquarie Group. However, recent APRA announcements fuel our expectations for an increase in bank dividends from here.



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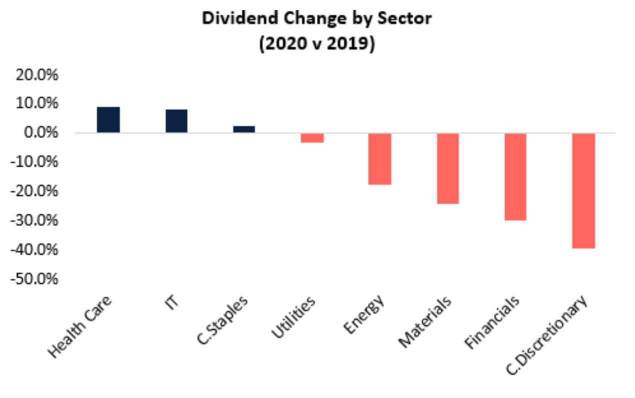

Source: Factset

What happened in global sectors?

- COVID-19, and the associated economic risks, continue to impact sectors differently. Comparing 2020 with 2019, dividends fell most in the Consumer Discretionary (-40%) and Financials (-30%) sectors. In stark comparison Consumer Staples (+2.2%), IT (+7.8%) and Health Care (+8.5%) were positive. This reflects the defensive nature of Staples and the benefits to Health Care and IT from a health driven pandemic and the associated move to lockdowns and working from home.
- Materials (+14.3%) had the largest increase in Q4. Consumer Staples (+9.4%) continued to increase dividends, a trend from Q3. Significant dollar payers include DuPont de Nemours Inc, Walmart and Kraft Heinz Company.
- Focussing on Q4, Health Care continued its recent dividend growth (+5.6%). IT was slightly negative. Energy (-27.3%) continued to see dividends fall, reflecting a tough 2020 for the sector.
- Despite another -20% plus fall in dividends, Financials continued to be the largest dividend payer in AUD terms ($54.13bn AUD), contributing 17% of the total income in Q4.

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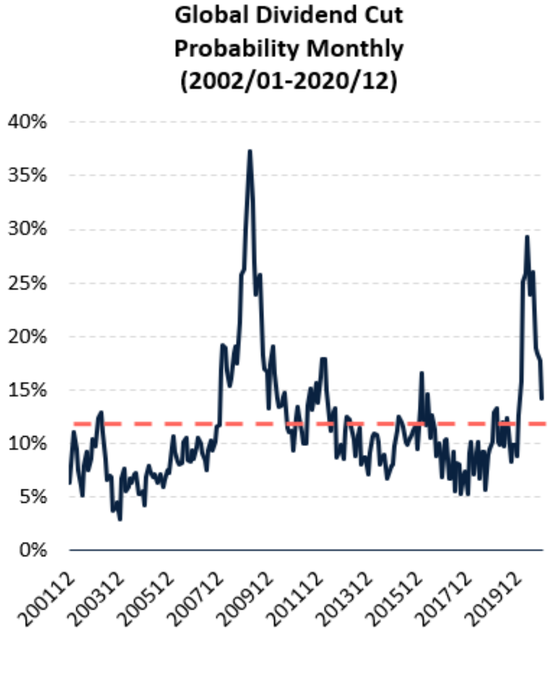
Interesting facts in global income

- When incorporating dividend cuts and initiations, 1.4 companies increased or initiated dividends for every one company that reduced or completely cut dividends versus the previous corresponding period. Although still significantly below pre pandemic levels, this ratio has increased since Q2 due to companies that had deferred now paying and the slowing pace of dividend reductions.
- Just under half (46%) of US companies that pay dividends increased or initiated them in Q4 (v Q4 2019), versus just over a quarter that remained unchanged. 43% of US companies paid out in the last 12 months. This was down from 49% in 2019.
- In 2019 65% of companies paid dividends. This fell substantially to 52% in 2020. Singapore, Portugal, Switzerland and Japan had a payer ratio in excess of 70%.



Source: Plato Investment Management

What's the outlook for global income?

Plato's proprietary dividend cut model provides insights into future dividends. It represents Plato's macro view regarding the likelihood that global developed markets will cut their income.

Despite the continued challenges to companies from the Coronavirus, our model predicts a substantial reduction in the level of dividend cuts. After the recent high of almost 30%, the reduced reading in Q3 (19%) continues to fall. We currently predict a 14% chance of global developed market dividends being cut.

Unsurprisingly the industries with a high risk of dividend cuts still include Entertainment, Transportation Infrastructure and Airlines.

In conclusion

- The dividend cut model was very accurate in predicting the magnitude of the dividend cuts in Q2 and the reduced risk in Q3. Plato are again hopeful that the further reduction in the probability will signal respite from companies cutting dividends, signalling a more positive 2021 for our income clients.
- Income from lower yielding segments of the market, including US, Japan, IT and healthcare, have held up in a relative sense. Recently outperforming growth stocks in such areas have seen less pressure on yield when compared to some of the underperforming value sectors.
- Our previous message remains relevant. The current environment is challenging and investors need to be cautious where they look for income. Stock selection, and avoiding dividend traps, remains key.

Methodology

1. The methodology uses dividends paid, in AUD, however the ex dividend date is used to allocate the dividends in the relevant time period e.g. Q3 2020.
2. Dividend paid ($) for each stock in each calendar quarter is calculated as the shares outstanding as of quarter end multiplied by the total gross dividend per share (DPS) paid out in the calendar quarter. The DPS paid excludes spin offs but includes capital returns and special dividends. Conversion to AUD is done using the prevailing WM/Reuters London exchange rates at the time of dividend payment.
3. Full year dividend paid ($) is the summation of dividend paid ($) from Q1 to Q4 using the methodology (1).
4. DPS movement is based on total DPS paid out (in local currencies) over each calendar quarter. DPS movement from quarter to quarter is then categorised as initiating, increasing, unchanged, decreasing or cut to zero.
5. Secondary issues are removed from the calculations to prevent double counting of income.